



Handelshögskolan  
VID GÖTEBORGS UNIVERSITET

# Moving the World to Islamic Banking

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A STUDY OF ISLAMIC BANKING AS A FINANCIAL SYSTEM AND AN ANALYSIS OF HOW IT  
COULD BE TRANSFERRED TO THE SWEDISH MARKET

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# Abstract

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This thesis provides an explanation of Islamic banking and its concept by the use of a case study of Malaysia, a pioneer within Islamic finance. Furthermore it investigates the implementation of the Islamic banking system in a Western country, where Sweden has been chosen as an example. In order to analyse the Swedish market, four different issues have been developed that an Islamic bank may encounter. Based on these issues a conclusion has been drawn.

Islamic banking is believed to be transferrable to the Swedish market, however the bank must acknowledge the circumstances which are specific for the country and thereafter develop a strategy that is unique in its way of doing Islamic banking.

*Keywords:* Islamic banking, conventional banking, finance, Malaysia, Sweden, marketing, international business.

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# 1. Introduction

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*This chapter will provide the background for the thesis and give a detailed statement of the purpose, as well as the problem identification. Additionally, there are delimitations throughout the study, which will be accounted for in the end of the chapter.*

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## 1.1 Background

In the repercussions of the recent years' financial crisis, a question mark regarding trust for the conventional banking system has arisen. During this period several financial markets have experienced a large downturn in customer trust, and this still constitutes a huge threat to the industry. Banking customers worldwide have realised the value that they offer the banks and have therefore begun to demand a more loyal relationship from the companies. Although the customers are still relatively reluctant to switching banks, they are believed to have come to a point where the effort of a change can be worthwhile in the search for a more loyal and safe alternative (Ernst & Young 2011).

In addition, an increasing interest for sustainable and ethical financial products has been noticed recently. In general, it is becoming more important for consumers to find financial products that offer both revenues and the opportunity to make a good deed, and the meaning of the investment is becoming more valuable than the actual profit (Svenska Dagbladet 2010).

Furthermore, with the ongoing globalisation there is an increase in the spread and exchange of information, cultures and values around the globe. This leads to people having a more open-minded attitude towards new business methods and alternative ways of doing business. In this changing environment, companies that provide options that go beyond the traditional easily become rooted onto new markets (Dicken 2007).

All of the above can be seen as some of the reasons to why Islamic banking, an almost unknown financial system 30 years ago, has developed and become a unique and growing segment in the international banking market (Elgar 2007). Throughout the development of Islamic banking, the system has been adapted differently between countries. Malaysia, a special case in terms of being a pioneer within Islamic finance, has been able to develop a dual system, whereby Islamic and conventional banking can co-exist. The dual system can be considered to be of great importance when transferring Islamic banking to Western markets since conventional banking is deeply rooted in these societies; thus it might be better for

Islamic banks to function alongside conventional banks rather than trying to conquer them out of the Western markets (Warde 2000).

A Western market that, from a macro and micro economical perspective, can be comparable to Malaysia is Sweden. Sweden as a country has been faced with the phenomenon mentioned above; lack of trust for conventional banking, increasing demand for ethical financial products and globalisation. However, as no Islamic banks are existing in the country, it can symbolise a Western market where a dual system could be developed and Islamic and conventional banking can function side by side. Hence, the possibility of Islamic banking in Sweden is of growing significance and an interesting topic to study further.

## **1.2 Purpose**

The purpose of this thesis is to study the Islamic banking system in order to promote it as an alternative to conventional banking in a Western market, such as Sweden, and if it is possible to improve the knowledge about this unique business model in the Swedish society. Furthermore, the purpose is to investigate whether the dual system, of conventional and Islamic banking functioning collaterally, would be transferrable to Sweden and its financial market. Therefore, a case study of Malaysia will be conducted to enable the investigation of the possibility of a transferrable system.

The purpose can be summarised in the three following questions:

- 1) What is Islamic banking and which values is the system based upon?
- 2) Is Islamic banking a transferrable system that could function together with the conventional system in a Western country, in this case Sweden?
- 3) How could Islamic banking be implemented in Sweden?

## **1.3 Problem Identification**

If a greater understanding for Islamic banking would be developed, this financial system could provide the individuals engaged in banking activities with a safer and more ethical alternative in comparison to conventional banking.

When Islamic banking is misinterpreted or wrongly connected to consumers prejudices of the religion of Islam, it reflects negatively on the companies that provides this type of banking service. Not only does this affect the banks and the financial system as a whole, it also affects the consumers, as they miss out on the positive attributes that the different products of Islamic

banking can actually provide. This is a problem that is likely to become even larger as Islamophobia is increasing around the world.

The unfamiliarity surrounding Islamic banking can also be considered as a contributing element to the lack of understanding, and worth mentioning is the fact that Islamic banking has not been existing for more than 30 years, in comparison to conventional banking which dates back to the 18<sup>th</sup> century. Hence, the consumer may be reluctant to any other way of borrowing than the one that they are used to. In Western countries, the conventional banking system has a long history which can contribute to the customers being more attached to this type of business model and thus not as willing to switch to a new alternative, which Islamic banking with its relatively short history can be perceived as.

However, the Islamic way of banking with its interest-free principles is not a new phenomenon as all major religions at some point during their history have been prohibiting it. Islamic banking can be seen as a more human option that is characterised by sustainability and social responsibility, thus it can appeal to all consumers regardless of their religion.

## **1.4 Delimitations**

When investigating whether or not Islamic banking is a transferrable system that could function alongside of the conventional system, a case study of Malaysia was conducted to gather information about how the two systems can co-exist. As Malaysia is a multicultural country that has been a pioneer within Islamic finance, it was able to provide a valuable overview of how a dual system can work in a country with similar features. Islamic banking could have been studied in a Middle East country as well, however Malaysia with its ethnically diverse population can be considered to be a better comparison to the Western society, where immigration has led to different religions being represented among the citizens.

Furthermore, the Western world was narrowed down to one of the countries that has been faced with an increasing lack of trust for the banking system during the recent years' financial crisis; Sweden. Another aspect that has made Sweden interesting for this study is the rise in immigration of Muslims that the country has experienced as well as the increasing trend towards a multicultural population, which to some extent can be compared to Malaysia, although the two countries greatly differ in other ways. Also, this thesis has first and foremost been examining how Islamic banking can be introduced and promoted to private persons within the Swedish society.



In addition, delimitation was made to only use interview respondents that were concerned with Islam as a religion, the conventional and Islamic banking systems as well as the two different countries. This was to ensure that the interviews were of importance for the study and to gather valuable information.

Since this study is conducted on a subject that is in its nature very broad, many of the chapters could have been further explored. However, the decision was made to focus on a few implementing strategies for Islamic banking in a Western country, and therefore four major issues were developed. From these issues, the strategies were derived and each one can be seen as general guidelines rather than an in-depth analysis. Thus, this thesis could encourage further research.

## 1.5 Disposition of the Thesis

A disposition of the thesis different chapters is presented in figure 1 and is thereafter followed by a short summary of each chapter.



Figure 1: Disposition of the Thesis.

### Chapter 1: Introduction

The chapter describes the background of the thesis and provides the purpose, problem identification, delimitations as well as a disposition.

### Chapter 2: Methodology

In this chapter the methods used for the collection and interpretation of data is presented. Furthermore the implementation of the case study and interviews are described.

### Chapter 3: Islamic Banking

Here the Islamic banking system is explained and compared to the conventional banking system. Additionally, a SWOT analysis of the financial system is conducted.

### Chapter 4: The Special Case of Malaysia

In this chapter a case study of Malaysia is executed and is based on three different parts; the background of Islamic banking in Malaysia, the dual system and Malaysia as a role model.

### **Chapter 5: Islamic banking – An Option for Sweden**

A macro and micro analysis is performed and a picture of the Swedish financial market is presented.

### **Chapter 6: Analysis**

Four different issues that an Islamic bank may encounter in the Swedish market are developed, followed by strategies that have been adapted after what is suitable to each issue.

### **Chapter 7: Conclusion and Recommendations**

In this final chapter conclusions, based upon the findings in the analysis, are drawn and the question formulation of the purpose is being answered. Recommendations for future research are also being presented.

## 2. Methodology

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*This chapter presents the methods used during the conduction of this study and gives a description of how the collected data has been processed. This is followed by a discussion of validity and reliability as well as a critical discussion of the sources that have been used.*

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### 2.1 Data Collection

For this thesis, our primary resource has been the Internet, which has been used as a search engine for general information about Islamic banking, and has in addition provided us with valuable literature and previous research. We have also used different databases, such as Libris, and examples of keywords that we have searched for are: Islamic, banking, finance, Malaysia and Sweden among others. In order to acquire a more precise result, some of the keywords have been combined. To obtain more relevant sources we have looked at reference lists of earlier researches that have been of relevance, and in addition these have been used as an inspiration regarding methodology. The literature that was mainly used in this study was found in the economical library at the University of Gothenburg.

### 2.2 Deductive and Inductive Theories

Empirical material is the foundation of a theory which the researcher discovers through the studying and gathering of information about a particular subject. This aims to impose a version of the reality as realistically as possible. The empirical material can be gathered through observations, interviews and marketing surveys, and can be either quantitative or qualitative material (Patel and Davidson 1991). Quantitative research often has a *deductive* view on the relationship between theory and research while qualitative research has an *inductive* view (Bryman and Bell 2007).

A deductive theory is the most common view of the relationship between theory and research. Based on what is known about a certain subject and on theoretical regards in relation to that subject the researcher derives a hypothesis, which then must be subjected to empirical examination. In other words, the theory leads to an observation or a finding. An inductive theory is the opposite of a deductive theory, which means that theory is seen as the outcome of research, and the process includes formulating a generalised conclusion from the observations (Bryman and Bell 2007).

## 2.3 Quantitative and Qualitative Research

*Quantitative* research is a distinctive research strategy that is based on the collection of numeric data, whereas *qualitative* research emphasises words and thoughts (Bryman and Bell 2007). A big difference between the two types is that when conducting qualitative research the researchers are constantly undertaking analysis of the gathered information, meanwhile the researchers using the quantitative method waits until the data has been collected to analyse the information (Patel and Davidson 1991). As our research has been based on information gathered from literature and interviews, a qualitative research method have been used.

In the qualitative method, the practices and norms of the natural scientific model have been rejected and instead the focus is on the ways in which individuals interpret the social environment around them (Bryman and Bell 2007). This often results in a research that is a combination of quotes and the authors' opinions. In addition, the environment of the subject is described in order to provide a deeper understanding (Patel and Davidson 1991).

## 2.4 Case Study: Malaysia

When writing a thesis, a case study can be conducted in order to obtain detailed information about a particular situation, organisation, individual or event (Glatthorn and Joyner 2005). The decision was made to use Malaysia as a case study in order to be able to explain how Islamic banking works in a country where conventional banking is still in majority. Another interesting aspect in Malaysia is how the country focuses its resources on developing a growing industry to become more competitive on the world market; Islamic finance.

In addition, a case study of Malaysia was undertaken as it is believed to be of importance in order to fulfill the purpose of the study, which is to investigate whether Islamic banking is a transferrable system and how it could work in Sweden.

During the stay in Malaysia, diverse parts of the society were explored that was thought to contribute to the general understanding of the current situation in the country and how this affects Islamic banking. A few examples of the places visited were the mosque, the library, schools, and conventional and Islamic banks. To develop the understanding even further, information was also gathered about Malaysia as a country during the interviews. Throughout the visit, a very varied group of people were encountered; all belonging to different ethnical groups, ages, occupations and backgrounds.

This is further being discussed and analysed in chapter 6; Islamic banking – An Option for Sweden, and chapter 8; Conclusion and Recommendations.

## 2.5 Interviews

### Purpose with the Interviews

The purpose of the interviews was to gain a deeper understanding of Islamic banking, beyond what can be found in literature. By conducting interviews with people that possess different knowledge and experience of Islamic banking, the readers of this thesis will be provided with more than pure information, and will be given personal opinions and individual explanations. This way, the readers will get a broader overview of the financial system. Furthermore, as a part of the purpose is to promote Islamic banking as an alternative to conventional banking, the personal responses gained in the interviews are believed to contribute to a positive perception of Islamic banking. Also, the interviews have been able to give a more open view towards Islam as a religion and Islamic banking as a financial alternative, which then can be transferred onto the readers.

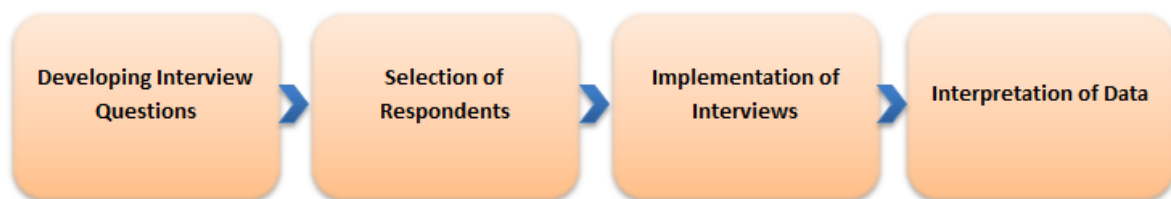


Figure 2: The Interview Process.

### Designing Interview Questions

The interview questions were based on the information about Islamic banking that had been found when writing the proposal for the thesis. Together with the supervisor, 9 questions were agreed upon and were used as a general outline during the interviews (Appendix A). However, there was no certain order followed during the interviews and mostly the respondents spoke freely. If questions arose after the interview there was the possibility to send follow up questions. Therefore, a semi structured interview method was being used, which is characterised by questions which are covering a fairly specific topic where the respondent is allowed to answer freely, but in addition allows the researcher to ask follow up questions. This type of interview additionally means that the questions not necessarily follows

a specific order and that questions that are not a part of the interview guide may be asked (Bryman and Bell 2007).

By developing the interview questions before choosing the respondents, the decision was made to keep the questions open and general. According to Bryman and Bell (2007) open questions are beneficial for the interviewer as it allows the respondents to answer as they please and can give rise to unique answers. Furthermore, these types of questions do not suggest certain kinds of answers to the respondents and can provide the researcher with information about subjects that he or she has limited knowledge and experience of. The decision to design open questions resulted in the interviews being individual and personal. This has also led to the interviews being conducted in a relaxed atmosphere, enabling the creation of personal relationships with the respondents, an important cultural aspect to take into consideration when being in Asia, which will be discussed further on.

### **Selection of Respondents**

The reason for the conduction of interviews was mainly to be able to confirm the information found in literature, such as books and articles. A large part of the interviews took place during a two week period in Kuala Lumpur, Malaysia, this due to the fact that the country has been a pioneer in developing Islamic finance. Also, Malaysia is a country where a majority of the population is practicing Islam. The choice of going to Kuala Lumpur and Malaysia was based on the belief that meeting the respondents in person would be much more beneficial as business in Asia is conducted differently and is considered to be a region that has a relationship oriented culture. This means that relationships are highly appreciated and that the people are feeling uncomfortable when dealing with strangers (Gesteland 2006). Therefore, it was significant to travel to Kuala Lumpur in order to establish a relationship with the respondents, making them feel comfortable, and by doing so managed to develop a network of people that has helped us during the study. This was also confirmed during one of the interviews where one of the respondents stated: *“When doing business in Malaysia it is important to be buddies, you need to build relationships with the people you are doing business with”* (Interview 1).

Through the interviews, contact with a broad variety of people in different positions was established, and all of the respondents have contributed to the study. To get an understanding of Malaysia as a business center, a meeting was conducted with a person at the Swedish Trade Council in his office situated in Kuala Lumpur. As his experience of Islamic banking was

limited, he provided contact with a man who for several years has been working for both conventional and Islamic banks; additionally he assisted the Bank Negara, the Central Bank of Malaysia, in the establishment of an Islamic bank. Before going to Malaysia, an appointment with a man working at the branch office for the Swedish bank, Handelsbanken was made and this meeting provided information regarding the Islamic banking system and how it works in the Malaysian society.

A meeting with a guide at the National Mosque was also arranged, in order to get a basic understanding of Islam as a religion and to acknowledge the importance of using Islamic banking for Muslims. The guide at the mosque kindly introduced a colleague of hers, which was very familiar with Islamic banking as a concept and he shared his experience of the financial sector in Malaysia. By spending time at the mosque, a meeting was arranged with a man, who was engaged in a movement called Islamic World Mint, and was an opponent to both conventional and Islamic banking. He was able to give a different point of view that had not been encountered earlier, and which has been useful when making a SWOT-analysis of Islamic banking.

### **Implementation of Interviews**

When leaving Sweden, only two interviews were confirmed beforehand and the others being arranged on the spot in Kuala Lumpur. Regarding those interviews that were confirmed, the questions were sent to the respondents in advance. The confirmed interviews enable contact with other people that had relevant knowledge within the field, and before leaving Malaysia seven different interviews had been conducted.

Due to the visit in Kuala Lumpur, contact has been made with people that otherwise could not have been participating in this study, as many of them were incapable of communication by other means, such as e-mail or phone. In addition, the personal meetings with the respondents provided more information than was asked for in the questions and many times the meetings went on for several hours. It is believed that this would not have happened if the interviews were conducted solely in Sweden.

All the interviews were arranged in a comfortable and familiar environment for the respondents, meaning that the interviews had been conducted in very different places such as an office, a restaurant, a mansion and a mosque. This contributed to the creation of a relationship with the respondents, and is believed to have made the respondents open to the questions and making them answer more honestly.

By being two when conducting the interviews, there was no need for the use of a Dictaphone. Instead, one was documenting what was being said throughout the interview on the computer and the other one paying full attention, listening to the respondent, and thereby making them feel relaxed and being the center of attention. As mentioned above, all the interviews have been implemented through personal meetings, which has meant that phone or mail has not been used for other than follow up questions.

### **Interpretation of Data**

Throughout the study, a running analysis has been made. After each of the meetings with the interview subjects, the interviews were being written in their whole. This is considered to have been an advantage since it contributed to an easier and more effective way of analysing the material. According to Patel and Davidson (1991), a running analysis is practical to use when working with a qualitative research method and it is an aspect where the qualitative method differs from the quantitative, where the processing is conducted after the gathering of material.

The advantage with the use of using a running analysis is that it can provide the researcher with ideas on how to proceed with the study. It is also beneficial since it means that the observation is kept fresh in the researcher's memory and this often results in the material becoming more vivid (Patel and Davidson 1991).

However when working with a qualitative method, the material is often very extensive and even a limited amount of interviews provide the researcher with a large amount of data that needs to be printed. Thus, this research method is considered to be time and work consuming (Patel and Davidson 1991).



## 2.6 Credibility

### Validity and Reliability

The gathering of information occurs every day, as people collect information about different situations. An example of such a situation can be as simple as the use of a scale when a person wants to find out their body weight. In these situations, the expression *validity* and *reliability* can be used to ensure that people know what they are doing. You have to know that you are investigating and what you intend to investigate to receive a high validity, and you have to know that the investigation is conducted authentically to receive a high reliability (Patel and Davidson 1991).

With the use of a qualitative method, validity and reliability interlaces. However, when doing a qualitative research the validity is more important to the study, and vice versa for the quantitative method, whereas the load of importance is on the reliability. When using the qualitative method, with a focus on the validity, the aim of the investigator is to find a phenomenon that can describe the life world and culture of the situation. When looking at the reliability of a paper, it is easier to find a true value with a quantitative research, whereas in the qualitative method the ambitions are different. When the researcher does not have a measure to see if the answers in an interview are true or false, the observations taken during an interview can be used as a base to see if what has been said is true or false (Patel and Davidson 1991).

In a quantitative study a variation in the reliability can often mean that the original statement is false, but in a qualitative method a disparity means that the study instead can lead to creating a better understanding of the specific situation. As in the qualitative method it is important to make the reader create its own judgment on the situation (Patel and Davidson 1991).

With the use of interviews, the investigations reliability is strongly related to the abilities of the interviewer and the respondent, as they make assessments when they register answers and observations. Thus, errors of assessments can occur which can have an effect on the reliability. This can though be avoided with the use of standardised interviews. In addition, the reliability is dependent on the effect of the interviewer that can appear with the use of interviews, which means that the interviewer behaves in a certain way during the interview so

that the respondents, consciously or unconsciously, understands what is expected of them (Patel and Davidson 1991).

### **Criticism of the Sources**

Criticism of the sources is an important aspect when doing research and it is necessary to be critical of the collected data (Bryman and Bell 2003). Criticism of the sources is a scientific method which aims to confirm if the content of a source is true or false, usable or unusable, that is to determine whether or not a source is reliable. Since the establishment of the Internet information has become much more accessible, and today anyone can publish anything online without reflecting over what is stated. Often, the so-called original information has been copied and pasted from several different sources. This makes it harder for the reader to know where the information originates from, which puts higher pressure on the individual Internet user to be critical of the sources (Nationalencyklopedin 2011 A).

Throughout this process several sources have been used which has provided information about the same subject, enabling the reliability of the sources and to gain objectivity. In addition to the literature and online documents, the interviews have been confirming the information that has been found and enabled a deeper understanding of the subject. During this study, only literature written by authors that have been believed to be trustworthy and with great experience in the field has been used. Worth noticing is that some of the literature used has sometimes been published a long time ago, but since the subject has its roots in the religion of Islam not much have changed over the years, which has been found when compared in different books. Therefore, the sources used are argued to be up-to-date and thereby of relevance for this study.

## 3. Islamic Banking

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*In this chapter Islamic banking and its characteristics are being presented and accounted for. This includes an investigation of the five religious features that must be followed by banks in order to live up to the rules and norms of Islam. Thereafter, a discussion about the differences between Islamic and conventional banking follows.*

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### 3.1 The Financial System

The possibility of a financial system that would conform with the laws of Sharia was discussed as early as in the 1940s (Warde 2000), but the idea was not put in practice until the establishment of a rural bank in Egypt in 1963, followed by a cooperative bank in Pakistan in 1965. Since the creation of the Islamic Development Bank (IDB) in 1975 (Elgar 2003), the Islamic banking system has developed into a rapidly growing segment of the international banking and capital markets. Today there are more than 200 Islamic banks operating in over 70 countries, including most of the Muslim world and several Western countries. In addition, there are 50 Islamic insurance (takaful) companies which are operating in 22 countries as well as Islamic investment houses, mutual funds, leasing companies and commodity trading companies. There are also hundreds of small Islamic financial institutions such as urban cooperative credit societies and financial associations that are operating at a local level and dealing with urban units, small business firms and individual households (Elgar 2007).

So what is Islamic banking? It is defined as those financial institutions that are based in their objectives and operations, on the Islamic law, the *shari'a*. Shari'a as a legal system is based on the code of behavior derived from the *Qur'an*, the Holy Book of Islam, and the Tradition of the Holy Prophet, the *Hadith*. For banks to be able to conform to Islamic rules and norms, five religious features must be followed in terms of investment behavior (Elgar 2007):

- *Riba* is prohibited in all transactions.
- Business and investment are based on *halal* activities.
- *Maysir* (gambling) is forbidden and transactions should be free from *gharar* (speculation or uncertainty).
- *Zakat* (almsgiving) must be paid by the bank to benefit society.
- All activities should be in line with Islamic principles, and there should be a special *shari'a board* that supervises and advises the bank on the property of transactions (Elgar 2007).

## Riba

Riba literally means ‘increase’ or ‘excess’ but is in the Qur’an referred to as any additional payments on whatever is loaned, meaning interest. As one of the interview respondents explained it: *interest comes in many ways, Allah calls it riba* (Interview 2). Riba is equal, not only to usury, but to all interest and is seen as unfair, exploitative and unproductive. It is therefore prohibited in Islam and Muslims should stay away from it for the sake of their welfare (Warde 2000). It is also stated in the Qur’an that those who ignore the prohibition of interest are at war with God and His Prophet Muhammad. Furthermore, Allah states that “*whoever eats of usury becomes the flesh and blood meant only for the hell fire*” (Interview 2). By prohibiting riba, Islam wishes to develop a society that is rooted on fairness and justice (Elgar 2007).

This, however, does not mean that capital is costless since it is only the predetermined pricing of capital that is forbidden. What it means is that owners of capital in the Islamic order do not have the right to demand a fixed return rate and cannot ask for any additional payment without sharing the risks involved. Islam prefers that the risk of loss is equally shared between two and lenders should be entitled to share any profits from a venture that they have helped to finance (Warde 2000). Thus, the sharing of profits is acceptable and has been the foundation for the development and implementation of Islamic banking. What differs profit-sharing from interest, and thereby makes it legitimate, is the fact that it is only the profit-sharing ratio that is predetermined and not the rate of return.

## Profit-and-loss sharing (PLS)

The concept of profit-and-loss sharing is built upon the idea that all profits and losses derived from a physical investment should be shared between the lender and the borrower, and should be based on the parties’ respective level of participation. This is what the Muslim world believes in (Interview 5). In Islamic banking, return-bearing contracts are used instead of interest-bearing, which means that the bank establishes a partnership with the borrower. Two types of partnerships exist: *mudarada*, which is a commenda<sup>1</sup> partnership or a finance trusteeship, and *musharak*, which is a longer-term equity-like arrangement. In both types of partnerships, the bank acquires a contractual share of the profits developed from business ventures. What differs profit-sharing from interest, and thereby makes it legitimate, is the fact

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<sup>1</sup> Commenda is a somewhat limited partnership (Hickson and Turner 2005).

that it is only the profit-sharing ratio that is predetermined and not the rate of return (Warde 2000).

The principle of PLS means that Islamic banks become directly concerned regarding the profitability of the physical investment, just as conventional banks are concerned about the profitability of the project, due to the risk of potential default on the loan. However, conventional banks emphasise the receiving of interest payments, agreed upon by the borrower, and the profitability of a conventional bank is not directly affected by the investment project's rate of return as long as interest is being paid. The profitability of Islamic banks, on the other hand, is directly connected to the real rate of return and the banks must thus focus on the return of the physical investment (Elgar 2007).

What also differs the profit-and-loss sharing contracts from the interest-based contracts used in conventional banking is the superior attributes for risk management, as the payment that the borrower makes to the bank is adjusted after the client's economic situation. Islamic banks regularly gather information about the situation of their clients, in order to calculate their share of profits. Due to this, contracts based upon the PLS principle are said to provide greater stability in the financial markets and encourages banks to acknowledge the importance of long-term relationships with their clients (Elgar 2007). This is confirmed in the interviews made, where Islamic banking is stated to be a safer option for the borrower, as a bank cannot demand payments if the client is incapable of paying (e.g. a business gone bankrupt), although this is not the case if negligence, mismanagement or fraud can be proven (Appendix F). The reason behind this is that Islamic banks are considered to be investors, in comparison to lenders, and thereby has a stake in the longer-term success of the client. Thus, the client can focus on a long-term endeavor that in turn could generate social and economic benefits to the society instead of being concerned with debt-servicing (Warde 2000).

The concentration on long run relationships in the profit-and-loss sharing philosophy may, however, result in higher costs within the Islamic banking system, because of the need for supervising the borrower's performances, and often means that the banks must invest more in managerial skills and expertise in order to analyse investment projects (Elgar 2007).

## Halal

Islamic financial activities must follow a strict code of 'ethical investments', meaning that Islamic banks cannot invest in business or goods that are *haram* (forbidden) in Islam. Haram is for example, pork, drugs including alcohol, prostitution and gambling. This is why

speculation within finance is not allowed as it is seen as gambling. Instead, Islamic banks must engage in activities that are permitted, *halal*, according to the shari'a law. In Islamic banking everything has to be pure and a person will not be able to get an account in an Islamic bank if he or she is not pure (Interview 2). Furthermore, Islamic banks are encouraged to prioritise the production of essential goods that satisfy the needs of the majority of the community, since the fulfillment of material needs is considered to assure religious freedom. In addition, it is seen as unacceptable for Islamic banks to invest in businesses that participate in the production and marketing of luxury commodities due to the lack of essential goods and services such as food, clothing, shelter, health and education that societies suffer from (Elgar 2007).

### **Maysir and Gharar**

The Qur'an forbids all types of gambling, *maysir*, as it allows the gambler to become wealthy without effort. Gambling, by being a game of pure chance, is thought of as unethical by the shari'a law as it contributes to the unjustified enrichment of society. Alongside gambling, the Islamic law also prohibits business activities which are engaged in or contains any element of gambling, resulting in that no Islamic banks are allowed to have these types of businesses as their clients (Elgar 2007).

In Islam, financial transactions that involves speculation, *gharar*, is another banned feature. The definition of gharar is hazard, but is in business terms expressed as speculation without adequate knowledge or as an extremely risky transaction. Speculative business, such as buying commodities or shares at low price in order to sell them for a higher price in the future, is considered to be gharar and thereby illegal. Gharar is also applicable to investments that include trading in futures on the stock market, and is in addition seen to exist in all future sales, due to the uncertainty over time. This condemnation of uncertainty and gharar has led to the rejection of insurance, since it contains an unknown risk, and as a result there has been a development of Islamic insurance, called *takaful* insurance (Elgar 2007).

### **Zakat**

According to the religion of Islam, social justice is of great importance and is accomplished through organising society on Islamic social and legal principles. By doing so, justice and equality can be obtained, meaning that all people will have equal opportunities in life. Islamic banks must be engaged in charity since the belief in Islam is that no brother within the Muslim community should be poor (Interview 5). To guarantee every Muslim a fair standard

of living, Islam has an implicit mechanism that enables a redistribution of income and wealth. Almsgiving, *zakat*, is the most essential instrument in order to redistribute income from the wealthy to the poor and is a mandatory levy within the Muslim community. Islamic banks and financial institutions, which operate in those countries where *zakat* is not collected by the state, must on their own create a *zakat* fund. This religious taxation should be collected from the initial capital of the bank, on the reserves and on the profits, and should be distributed by the banks directly to the poor or indirectly through a religious institution (Elgar 2007).

### Shari'a Board

All banks engaged in Islamic banking must establish a *shari'a board*, which is a committee of religious advisers that will ensure that the activities and instruments of the banks are in compliance with the ethics of Islam. When needed the board also controls the collection and distribution of *zakat*. The *shari'a* board constitutes an additional layer of governance, making Islamic banks differ from conventional (Warde 2000).

## 3.2 The Differences between Islamic and Conventional Banking

Today, Islam is the only religion that still maintains the prohibition of usury, although this has not always been the case. The two other Abrahamic<sup>2</sup> religions, as well as Hinduism, have earlier forbidden usury (Elgar 2007). All big religions were previously against interest rates as this is stated out of the holy books (Interview 4). In Christianity, there were prohibitions or strict limitations upon usury for more than 1400 years, meaning that the taking of all types of interest was permissible. However, this has gradually changed within these religions through the development of laws to abolish only exorbitant interest, and this excessive type of interest is still considered to be usurious (Elgar 2007).

Both Islamic and conventional banks act as intermediaries and trustees for their customers' assets. What differs Islamic banking from the conventional system is how it shares its losses and profits with its clients, meaning that an element of mutuality is created and that the depositors are offered certain owner-ship rights (Dar and Presley 2000).

The risk-sharing philosophy of Islamic banking is based on the belief that the lender must share the borrower's risk. When using predetermined interest rates, as in conventional banking, a return to the lender is guaranteed and strikes the borrower disproportionately, which in the religion of Islam is seen as economical waste and inappropriate in a social

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<sup>2</sup> The Abrahamic religions consist of Christianity, Judaism and Islam (UR 2011).

context. Therefore, profit-and-loss sharing (PLS) is preferred in Islamic banking, compared to conventional banking where the interest-based principle is used. By using the PLS principle, Islamic banks are able to create a relationship between borrower, lender and intermediary that is built on financial trust and partnership (Yudistira 2003). Another vital element in Islamic banking is the need for social and economic development accomplished through business practices that are in line with the Islamic principles and through zakat.

Both Islamic and conventional banks are governmentally regulated, additionally Islamic banks must have a shari'a board to control that they are following the religious guidelines of Islam, as mentioned earlier.

In comparison to a conventional bank, which basically can be seen as a borrower and lender of funds, an Islamic bank is considered to be a partner with its depositors, on the one hand, and a partner with entrepreneurs, on the other hand, when disposing the funds of the depositors in productive direct investment. This means that Islamic banks have different stockholder relationships since the depositors are directly involved in the financial stake in the banks' investment. The fundamental philosophy of Islamic banking is to meet the financial needs of its participants with integrity and in a manner that is just, fair, trustworthy and honest (Interview 3). The governance structure of Islamic banks is yet another aspect in which they differ from conventional banks, as the banks must meet the expectations of the Muslim community and follow the rules of the Qur'an by offering financing methods that are acceptable within the religion of Islam (Al-Bab 2011).

In Islamic banking, one of the main visions is to, through the financial system, create a society which is built upon an equal distribution of credit in order to diminish poverty, unemployment and concentration of wealth and income. The banking system aims to be a counterpart to the conventional, which in Islam is considered to contribute to making the rich richer by exploiting the poor (Elgar 2007).

To summarise, the main differences between Islamic and conventional banking are the different principles regarding the use of interest, and while the conventional system emphasises profit-maximisation within the legal framework, the Islamic banking system is in addition led by ethical and religiously inspired goals. We believe that the differences can also be summarised by using an expression from one of our interview participants: *"Islamic banking is simply more human"* (Interview 5).



### 3.3 SWOT: Islamic Banking

To be able to examine if the Islamic banking system is transferrable, an analysis has been made to present the strengths, weaknesses, opportunities and threats that are related to Islamic banking. A strategic overhaul has been provided through this analysis, which later has been used as the foundation for the development of the strategic options, presented in chapter 7; Analysis.

#### Strengths

As mentioned above, Islamic banking can be seen as a safer option in comparison to conventional banking, this due to the belief of the bank being an investor rather than a lender. This means that Islamic banks are very cautious as they lend money to their clients; they always go for safe bets. So for the client, Islamic banking is a much safer option (Interview 5). Therefore, the risk for the borrower of capital is much smaller when using an Islamic bank, which may attract clients. In addition, the Islamic banking system, based upon the principle of profit-and-loss sharing, is said to contribute to a greater stability in the financial markets, something that might be welcomed after the recent years' financial crisis (Elgar 2007).

Islamic banking could also appeal to people since it has a human and ethical aspect that conventional banking is considered to be lacking. An important element in Islamic banking is the almsgiving, the zakat, which means that the banks must contribute to the society economically. This results in the banks being an important part in the creation of a society that strives to decrease poverty and inequality. Thus, the clients can indirectly participate in the building of a just and fair environment within their community, which could be of interest to people as ethical alternatives today are in increasing demand at all levels of society (Warde 2000). Additionally, non-Muslims have found that the shari'a compliant services are fairer than the services offered in traditional banking (Interview 3).

Another important aspect in Islamic banking is the building of relationships, which is emphasised as it creates loyalty and trust between the client and the bank. The creation of relationships has become more significant during the last decades since customers want a more personal and closer contact with service providers. In addition, it leads to a perception of closeness and commitment making the customers feel important (Berry 1995). Thus,

Islamic banks have an advantage, as they meet the demands of the consumers in regards of commitment and trust.

Furthermore, an Islamic bank is being regulated from both the central bank and the shari'a board (Interview 3). This can be positive for the stakeholders of an Islamic bank as it decreases the possibility for the bank to become involved in risky ventures.

### **Weaknesses**

One of the weaknesses in Islamic banking is that the system has been criticised by financial scholars and is sometimes said to be no different from conventional banking except for the name. The system has also been claimed to use the term Islamic as disguise in order to attract clients and that there is no such thing as an interest-free banking model, suggesting that *riba* is just another word for interest. This criticism will have a negative impact on Islamic banking, making people reluctant to use the system (Warde 2000).

Another weakness in the Islamic financial system is the thorough analysis that is made on the investment projects, as mentioned earlier, meaning that it can be harder to become a borrower in an Islamic bank than in a conventional bank. Not only are the investments analysed in terms of how safe they are for the bank to be engaged in, they must also be examined so that they are not connected to anything that is considered to be *haram* (Elgar 2007). Thus, Islamic banking is considered to be somewhat niched as it is selective in its choice of clients and thereby not available to everyone.

### **Opportunities**

One of the greatest opportunities for Islamic banking could be the lack of trust that has been developed for the conventional banking system throughout the recent years' financial crisis (Bank Systems & Technology 2008). In March 2011, Ernst & Young conducted a survey in which the company found that 44% of retail banking customers worldwide claim that their trust for the banking industry has diminished during the past 12 months (Ernst & Young 2011). As a result of this, Islamic banking could gain a stronger position on the financial market if being presented as a safer option to the clients as well as an option that provides more stability in the financial market.

Islamic banking has moreover been the recent focus of economists worldwide as these banks have been less affected throughout the financial crisis that struck the world market in 2008-

2009. The reason for this is that Islamic banks, in comparison to conventional banks, do not borrow in interbank markets, instead their funds come from their own deposits. Additionally, the Islamic banks have not been engaged in collateralised debt obligations as they are prohibited by the shari'a law to hold interest bearing securities. This has made Islamic banks much more attractive to investors, as many of the investors based in conventional banks have witnessed a decline in the value of their assets (AMEinfo 2009).

The growing Muslim population in the world could also be seen as an opportunity for Islamic banking. Over the next 20 years, the world's Muslim population is expected to grow twice as fast as the non-Muslim population, and by 2030 Muslims are anticipated to constitute more than a quarter of the global population (The Australian 2011). Due to this, Islamic banking will have the ability to appeal to a great part of the world population, and these booming figures can be considered to be a great possibility for Islamic banks as they might represent future clients. This type of demographic change can also mean that the Western society and culture will undergo a transformation during the next decades, where Muslims gain more influence, which may reform the Western way of thinking (The Telegraph 2009). Thus, the demand for Islamic banking may rise in all parts of Western societies, creating a chance for the Islamic system to constitute a fierce competitor to the conventional system on the financial market.

In addition, there has been an increasing focus on the development of ethical investment alternatives during the last decade, since people are demanding products on which they can make a profit while at the same time contribute to a positive difference of the world (London Stock Exchange 2010). This shift in demand could be beneficial for Islamic banking, due to its ability to offer financial investments which can be considered as more ethical, in comparison to the investments provided by the conventional banking system.

## Threats

Over the last 30 years, Islamic banks have become established on the financial market, and during this time their success has posed a threat to conventional banks, and still does. As a result, conventional banks have begun to set up Islamic windows, since they do not want to lose clients to their Islamic counterpart. The Islamic windows are independent divisions within the conventional banks that are being monitored by a shari'a board so that their financial practices are in line with the Islamic law. With the introduction of Islamic windows conventional banks have been able to offer financial products that are shari'a compliant and

have thereby managed to compete with the Islamic banks, thus constituting a threat (Islamic Finance Asia 2011).

In addition, a recent study made by researchers at Northwestern University and the University of Arizona stated that the role of religion is becoming less significant in Western societies today. The researchers found that religion, as a part of everyday life, is gradually dying out and the number of people that claim to have no religious connections have been steadily rising over the last century (TIME 2011). Due to this, a financial system that is strongly connected to religion and based on religious beliefs, which is the case with Islamic banking, will possibly be perceived as strange in the western part of the world. Therefore, Islamic banks that are trying to become established on Western markets can find it difficult to attract customers that are non-Muslim.

Furthermore, the perception of Islamic banking in the Western countries can be hard to separate from people's general opinions of Islam as a religion, and the financial system might therefore be perceived as monolithic, rigid and an old-fashioned belief system that cannot be easily adapted to the contemporary world economy (Warde 2000). The system has often also been accused of being connected to terrorist organisations and Islamic extremism, a tendency that followed the attacks on September 11 and seems to still be in place (The New York Times 2007). Thus, Islamic banking has gained a harmful reputation around the world, which can be seen as a threat to the system.

What also is believed to constitute a threat to Islamic banking is a movement introduced by an organisation called the World Islamic Mint (WIM), which is convinced that neither conventional banking nor Islamic banking is a good option and therefore manufactures the gold dinar and the silver dirham. The dinar and the dirham are gold and silver coins that according to WIM is the most stable currency in the world as it is free of interest and independent of the financial system. The organisation is reluctant to the use of all paper assets, such as bonds, shares and paper-money, because it is considered to be a promise of payment, which is illegal in Islam, as well as an instrument that has been used for default and for cheating Muslims throughout history (World Islamic Mint 2011). The Islamic banking system is being criticised by the organisation for being a mirror of the conventional system veiled behind the name of Islam, and for not following the Qur'an. As stated by one of the interview respondents: *"Just because it is called Islamic banking does not make it Halal"* (Interview 4). As this revolutionary movement is spreading across countries, among them

Western societies such as Great Britain and the United States, commending people to abandon paper assets and instead use the gold dinar and the silver dirham, it will constitute a threat to Islamic banking as a financial system. The movement can also be seen as a threat to Islamic banking in Sweden as the ideas might transfer from nearby Western countries.

<b>Strenghts</b>	<ul style="list-style-type: none"> <li>• A safer option compared to conventional banking.</li> <li>• More human and ethical.</li> <li>• The building of relationships is an important aspect</li> <li>• Regulated from both the shari'a board and from the central bank.</li> </ul>
<b>Weaknessess</b>	<ul style="list-style-type: none"> <li>• Has been criticised for being no different from conventional banking except for the name.</li> <li>• Harder to become a borrower.</li> <li>• Somewhat of a niche bank due to its selectiveness.</li> </ul>
<b>Opportunities</b>	<ul style="list-style-type: none"> <li>• The lack of trust for conventional banking has risen during the recent year's financial crisis.</li> <li>• Has been less affected throughout the financial crisis.</li> <li>• The Muslim population is growing in the world and is expected to constitute more than a quarter of the global population by 2030. Thus, the Muslim population will gain more influence and may reform the Western way of thinking which can lead to an increasing demand for Islamic banking.</li> <li>• Increasing focus on the development of ethical investments alternatives during the last decade which can be beneficial for Islamic banking.</li> </ul>
<b>Threaths</b>	<ul style="list-style-type: none"> <li>• The establishment of Islamic windows means that conventional banks can compete with Islamic banks.</li> <li>• Religion is becoming less significant in Western societies. Therefore it will be hard for Islamic banks to attract customers that are non-Muslims.</li> <li>• The perception of Islamic banking can be hard to separate from people's general opinion about Islam as a religion. The system has also been accused of being connected to terrorist organisations and Islamic extremism.</li> <li>• The organisation World Islamic Mint (WIM) has started a movement to convince the public that neither conventional nor Islamic banking is a good option and instead believes that the world should return to the use of gold and silver as payment alternatives.</li> </ul>

Table 1: Summary of the SWOT-analyse.

## 4. The Special Case of Malaysia

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*Malaysia was one of the pioneering countries in the development of Islamic banking; today conventional and Islamic banking co-exists in the multicultural society of Malaysia. This chapter will describe the special case of Malaysia, a country in which Islamic banking has developed rapidly, and provides information of how the two systems can function side-by-side. There is also a debate on how Malaysia can act as a role model for other countries such as Sweden on how the two different types of system can work together.*

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### 4.1 The Background of Islamic Banking in Malaysia

Malaysia, as one of the first countries to have introduced Islamic banking, is deeply committed to further develop a complete Islamic financial system. The first Islamic bank was established by the Malaysian government in the beginning of the 1980's and was the country's first step towards the development of a dual system, where Islamic banking could function parallel to the conventional system. It was also the government in Malaysia that introduced the concept of the Islamic window, which at first was promoted solely for the three major conventional banks; however the concept was quickly extended to every financial institution in the country. Financial products were developed accordingly with the establishment of Islamic banks and windows, and these were not only marketed to Muslims but were aimed towards non-Muslims as well (Haron and Wan Azmi 2005).

The Malaysian central bank quickly realised the potential in developing Islamic banking, and saw the possibility to create a financial centre in Malaysia, and therefore has spent a lot of money on this (Interview 5). This has meant that a liberalisation of the Islamic banking sector has been necessary. Therefore, the government opened up the financial market for foreign financial actors in 2004, and as a result the market is characterised by high competition (Haron and Wan Azmi 2005).

Worth mentioning is that although the country is run by a government favoring Muslim values, the law is based upon English common law. Islamic law is only applied to Muslims in regards to family and religious law. This has led to the creation of a brand of Islam that is pragmatic and tolerant (The World Factbook 2011).

What differs Malaysia from other Islamic countries is how the Malaysian government has managed to implement a parallel system, where Islamic and conventional banking can

function alongside one another, rather than full Islamisation (UKM 2004). By doing so, the central bank in Malaysia, Bank Negara, has been able to stay partly out of the global financial crisis. The main reason for this is the regulatory framework that the country has adapted in order to include the Islamic banking sector. Thus, through the development of a dual system, Malaysia has been relatively excluded from the effects of the financial crisis (The World Factbook 2011).

As mentioned in chapter 3, there is a need for a shari'a board when engaging in Islamic banking. In Malaysia, the National Shari'a Advisory Council was established in 1997 with the primary purpose to be the single authoritative body to guide Islamic banks and to assess new products that are being developed within the industry (Bank Negara Malaysia 2011).

## 4.2 The Dual System

The banking system in different countries can be divided into a few categories, which are based upon the banks implementation of Islamic banking. The categories vary from those banks that have adopted solely the Islamic banking system to those that only practices the conventional system, where the dual system falls in between. Malaysia is the one country that has implemented the dual system and has managed to have a complete Islamic banking system which co-exists with a conventional system. Additionally, the two systems use principally the same banking infrastructure (MOF 2003).

In comparison to other countries, Malaysia can benefit from the implementation of the dual system. The reasons for this are that the country has the opportunity to offer its Muslim citizens a modern banking system that is not involved with *riba*, and the country is able to offer a larger amount of financial products to the public than countries that only implement one of the two systems. Therefore, it can be said to be better to have a dual system where the conventional and Islamic financial system can function together rather than just implementing one of the two systems (MOF 2003). As stated in one of the interviews: *"The dual system in Malaysia has made comparisons between conventional and Islamic products possible and also introduced it to a new and unintended consumer/corporate market"* (Interview 3).

## 4.3 Malaysia as a Role Model

### Multiculturalism

As a result of colonisation and heavy immigration from other countries, Malaysia became at an early stage transformed into a multicultural nation (Abdullah and Pedersen 2006) and today the population is composed by 50.4 % Malay, 23.7% Chinese, 11% Indigenous, 11% Indians and 7.8 % others (The World Factbook 2011).

In terms of beliefs, Malaysia did not possess any official religion until the 12<sup>th</sup> century when the Indian Muslim traders entered Malaysia and introduced the citizens to Islam (Abdullah and Pedersen 2006.) Malaysia has since then been a Muslim country, although currently only 60.4% of the population in Malaysia see themselves as Muslims. Other large religions are Buddhism 19.2%, Christianity 9.1% and Hinduism 6.3% (The World Factbook 2011).

More countries will probably, due to the ongoing globalisation, be faced with a demographic change that is similar to the one in Malaysia. Therefore, Malaysia can function as a role model since the country, with its population consisting of a broad variety of ethnic groups and different religions, has managed to develop a financial market that can meet the demand and needs of the multicultural public.

### Openness and Adaptation

During, as well as after, the process of implementing the Islamic financial system, the Malaysian government has kept an open-minded and pragmatic approach. The government has also acknowledged the need for research and development in order to adapt the financial market to the dual system. This has been said to be the single most important factor in the country's success in the development of Islamic banking (MOF 2003).

Furthermore, the belief of the Malaysian government, which has been the founder of Islamic banking within the country, is that the Islamic financial system cannot be solely implemented on the basis of profit-and-loss sharing. This has meant that the government has been focusing on developing other financing forms, such as leasing. However, these products have been developed so that they reflect the values and ethics of Islam, meaning that they are shari'a compliant (MOF 2003).



Malaysia is an excellent example of how openness and tolerance can lead to a successful implementation of the Islamic banking system. The country has managed to adapt Islamic banking to the micro and macro economical specific environment of the Malaysian society, therefore Malaysia can be seen as a perfect role model as it has found its own creative way of doing this type of banking.

## 5. Islamic Banking – An Option for Sweden

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*This chapter will provide an examination of Sweden as a country, both from a macro and micro economic perspective. The macro economic analysis is based on the PESTLE-model, which describes the different factors of the Swedish society that an Islamic bank needs to take into consideration before entering the country. The micro economic analysis will present the conditions of the Swedish financial market, describing the competitive environment and the consumer behavior.*

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### 5.1 Macro Analysis

#### Political

Sweden is a democratic constitutional state with a parliament that until recently consisted of seven different parties, some representing the right wing and some representing the left wing (Nationalencyklopedin 2011 B). However, in September 2010, the Swedish extreme right hand sided political party Sverigedemokraterna (SD) entered the Swedish Parliament. The party's main focus is on developing a responsible immigration policy, this meaning having a stringent outlook on all types of immigration, strengthening of Swedish culture and heritage, as well as halting the phenomena of multiculturalism (Sverigedemokraterna 2011). According to the latest research by Metro and Yugvos, Sverigedemokraterna is currently the fourth biggest political party in Sweden (Metro 2011).

Since the entrance of Sverigedemokraterna into the parliament, the party's main questions have been given more focus on the political agenda and the work against xenophobia has increased. Therefore, the Swedish government is undertaking research regarding the knowledge of xenophobic and intolerant attitudes (Politico 2011).

#### Economical

The three most important functions within the Swedish financial system are to provide an efficient payment system, transform savings into financing, and risk management. Laws that regulate operations within the financial markets have been developed as it is necessary to maintain the trust and function of the financial system within the society. Banks constitute an important part of this, and there are several laws and regulations that control the banking operations. The Swedish central bank, Riksbanken, and the Swedish Financial Supervisory

Authority are responsible for making sure the laws and regulations are being followed and to maintain financial stability. While the central bank has a comprehensive mission to contribute to the stability in the financial system's functioning, the Financial Supervisory Authority has direct responsibility over all companies in the financial market (Svenska Bankföreningen 2010).

### *The Swedish Financial Supervisory Authority*

The Financial Supervisory Authority functions under the Ministry of Finance and controls all financial companies. It supervises the financial system so that it works efficiently and so that it satisfies the demand of stability, it also operates to provide consumer protection (Finansinspektionen 2011 A). The legal framework that regulates banks and other financial institutions are developed by the Swedish Parliament, within this framework the Financial Supervisory Authority has the ability to formulate rules regarding the financial operations. Moreover, it provides the financial companies with general advice that is not mandatory, but is believed that the companies should follow them in order to practice what is considered to be stable activities. In addition, banks and financial institutions can only be conducted with permission from the Financial Supervisory Authority, which supervises these companies through inspections and extensive controls; it also performs current analysis of the companies' economical position and risks (Svenska Bankföreningen 2010).

### *Riksbanken: the Central Bank*

In Sweden the central bank operates as an authority directly subordinated to the Parliament. However, the central bank has an independent position towards politics, prescribed by law, which means that the politicians cannot govern the central bank themselves. Instead a path has been chosen to perform this task, and it is prohibited to operate on directives from politicians or others. The central bank's primary goal is to control the inflation so that it is low and stable, which means that the central bank is responsible for the monetary policy, and thereby has the opportunity to regulate the inflation through interest. It is also in charge of supervising the system that enables payments within the economy to function safely and efficiently as well as be in a state of readiness so that it can handle a financial crisis (Riksbanken 2011). The central bank accomplishes this by analysing the risks and threats that the financial system is exposed to. With this in view, the central bank also analyses the payment system and the development of the larger banks, the bank's borrowers and the macroeconomic development (Svenska Bankföreningen 2010). In addition, the Swedish

central bank issues money and administrates the country's reserves of foreign currency and gold. In other words, it can be seen as the bankers' bank (Riksbanken 2011).

### *The Role of the Banks*

The core business of Swedish banks is to handle deposits and to grant credits. Households constitute the largest part of the deposits, with 43 %, followed by corporations at 27 % and the foreign public at 20 %. Earlier, only banks were allowed to receive deposits, but from 2004 other companies operating in the credit market are permitted to handle deposits as well. The lending to the Swedish public is foremost made by banks and by institutes of housing. In 2009, 36 % of the lending was made to companies, while households and foreign borrowers constitute 26 % and 31 % respectively. The transfer of payments is, alongside lending and borrowing, an important function of the banks, and the Swedish payment system is technically well developed and characterised by high efficiency. This results in payments being realised safely, fast and at low costs. The system is built to execute payments, but also security paper transactions are a part of the financial infrastructure, which in turn is a significant feature in the total Swedish infrastructure. In addition, an important task for the banks is to offer corporations and private persons the possibility to decrease, reallocate and distribute risk, for example through trade with futures and option contracts (Svenska Bankföreningen 2010).

### *The Role of the European Union*

As a member of the European Union, Sweden must obey to its rules. In January 2011, a new structure for the supervision of the financial markets within the union was introduced; the European System of Financial Supervisors, ESFS. Within this new system, different authorities are operating with the aim to harmonise economical rules and to coordinate the supervision in the EU. The Financial Supervisory Authority is actively participating in this work while the Swedish central bank has the right to vote in the union. This means that the EU plays an important role in the Swedish economy (Finansinspektionen 2011 B).

### *The Financial Crisis's effect on the Financial Market*

Sweden is one of the countries that was not influenced by the direct effects of the financial crisis; instead it has been the indirect effects caused by the crisis that has been the major problem. Sweden has been faced with falling stock exchange rates and generally a worse conjuncture, which has led to a decreasing confidence in the banks as well as the country's

economy as a whole. Meanwhile, the export companies in the country have been affected by a bad international conjuncture and a weak dollar rate. Due to the inflation, the central bank has been forced to increase the interest which means that the cost for loans has risen. As many Swedes have been worried about the Swedish bank system, the Financial Supervisory Authority has studied the system and has found that it is robust (E24 2008).

## Social

Sweden has a high proportion of immigration and foreign-born residents, as well as developed integration policies, which aims to foster immigrants into Swedish culture but at the same time making sure they can practice their own native language and culture. The outcome has resulted in Sweden being greatly influenced by different cultures and values and is already a multicultural society, but is every year moving towards a greater sense of cosmopolitanism (Sweden 2011 A).

As figure 3 shows the largest groups of immigrants in Sweden during 2010 were Somalis and Iraqis. Somalia is an Islamic country where most of the population is Muslim (Sida 2011 A). Iraqis, which is the second largest group of people immigrating to Sweden, are also a part of the Muslim community (Sida 2011 B).

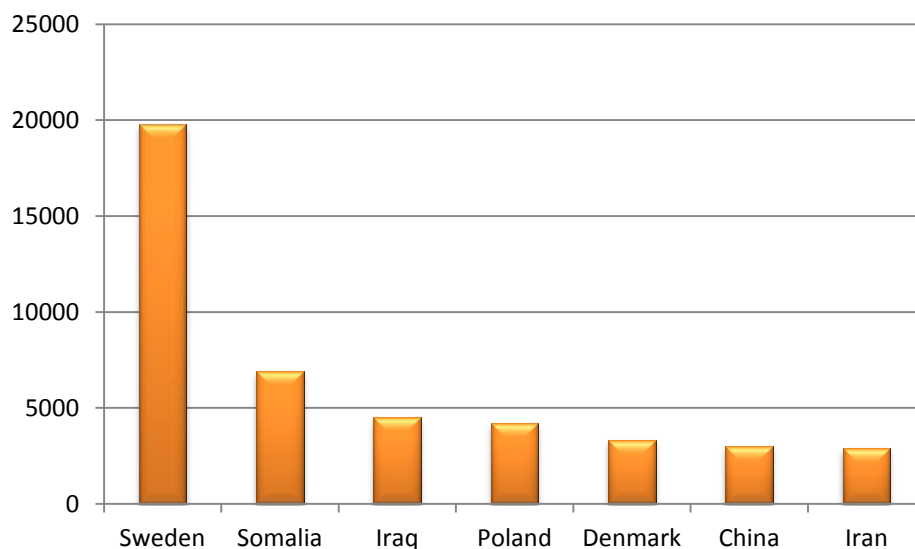


Figure 3: Immigration Based on Citizenship in Sweden during 2010. Source: Migrationsverket 2011.

Sweden is a Christian country belonging to the beliefs of the Lutheran Church (Nationalencyklopedin 2011 C). However Sweden is one of the most non-religious states in the world, only 17 % state that they believe in any religion (Dagens Nyheter 2009). Sweden's second biggest religion is Islam, and the amount of Muslims in Sweden is said to be around 250,000 – 350,000 (Nationalencyklopedin 2011 C). Furthermore, the Swedish population is predicted to consist of nearly ten per cent Muslims by 2030 (The Australian).

However as the fear of 'Islam taking over' (The Telegraph 2007) has arisen around Europe as extreme right hand parties are on the growth, the Swedish government has recently created a special research regarding Islamophobia, this is in order to survey why this phenomenon has lately occurred throughout Sweden. The aim with the study is to advocate for betterment in the Swedish integration politics and the understanding of different cultures (Regeringen 2011).

### Technological

In an international context Sweden invests greatly in research and development (R&D), and has the highest R&D actions out of the OECD countries. Since 2001 R&D operations in Sweden has expanded and now also involves the financial industry, such as banks and insurance companies (Statistiska Centralbyrån 2010).

### Legal

Swedish law belongs to the 'Nordic law branch', and is influenced from the Anglo-Saxon Common law and from the Roman Civil law, although since becoming a member of the European Union, the Swedish law has been highly integrated with EU legalisation (Nationalencyklopedin 2011 D). The banking industry in Sweden is monitored by the Swedish Financial Supervisory Authority. Their work is based on Swedish, European and International law. The authority gives recommendation on complementing constitutions, as well as advice to the finance market in general (Finansinspektionen 2011 A).

According to the Swedish Financial Supervisory Authority, there are no obstacles for performing Islamic Banking; however there are a few problems that may be encountered for Islamic Banks when operating in Sweden. One of them is concerning real estate, as in Islamic Banking it is common to own property which then can be sold to the banks' customers, whereas in Sweden this is illegal for banks. Another aspect to take into consideration for

Islamic banks is that the religious advisers included in the management team of the bank have to undergo the Swedish Financial Supervisory Authority's customary management assessment. Also the Islamic banks could have problems with taxation in regards to different charges of interest. Additionally, the Swedish consumer legalisation states that the clients of the banks shall have the right to pay off debt in advance of the decided end date of the loan, and according to the Islamic way of doing banking it is uncertain on how long a relationship with the banks' clients may last for. Furthermore, in the civil law which influences the Swedish system, there are regulations that might conflict with the Islamic way, such as the obligation to pay an interest fine when doing cross-border payment (Finansinspektionen 2008).

## **Environmental**

Sweden is one of the pioneering countries in corporate social responsibility (CSR) and has for a long time has emphasised the importance of it; in 2007 Sweden was ranked highest for trying to fulfill the goals of CSR. Therefore, when doing business in Sweden, it is important to please the companies' stakeholders in the form of CSR activities (Sweden 2011 B).

The Swedish banks have been working with social responsibility over a long period of time and have been engaged in different projects concerning the environment, charity and ethical guidelines (Svenska Bankföreningen 2008).

Another growing segment within the financial industry is social responsible investments, which are investments where companies, whose products and business practices are hurtful for individuals, communities and the environment, are being avoided. Examples of such companies are tobacco and weapon manufacturers (Social Investment Forum 2011).

## **5.2 Micro Analysis**

### **The Competitive Environment**

In Sweden, four large banks dominate the financial market; Nordea, SEB, Handelsbanken and Swedbank. From the mid-1990s these banks have developed into financial corporate groups with extensive international operations. These corporate groups have been developed as parts of the business, such as insurance, fund management and home loans, and have become significantly important next to the traditional banking activities. The corporate groups have

also been able to develop as they have expanded their operations internationally, foremost in the Scandinavian and Baltic countries (Svenska Bankföreningen 2010).

Nordea is the largest financial corporate group within Scandinavia, with more than 30,000 employees, and is constituted by banks and affiliates that are among the largest on the markets in Sweden, Finland, Denmark and Norway. Nordea's operation in Sweden comprises one of the largest Swedish finance companies as well as fund management and home loan operations. Additionally, the bank is the owner of the giro payment system, Plusgirot (Nordea 2011).

SEB is the financial corporate group that has developed extensive international operations in countries such as Germany and in the Baltic. In Sweden, the bank has a strong position in mainly fund management and insurance, as well as in home loans and finance corporation activities. Traditionally, it has also been an important player on the equity market, within foreign exchange trade and international payments (SEB 2011).

Handelsbanken, with more than 460 offices in Sweden, owns the institute of housing Stadshypotek, one of the major players on the Swedish home loan market. Furthermore, the bank has significant operations within fund management and finance corporation activities. Handelsbanken has additionally been growing in Scandinavia and the United Kingdom, both through acquisitions and the establishment of branch offices (Handelsbanken 2011).

Swedbank has an extensive office network in Sweden with roughly 420 offices. In addition, the bank is collaborating with the freestanding trustee banks and the joint-owned banks within the trustee bank industry. The corporate group also includes the largest company within fund management in Sweden, Swedbank Robur, and one of the largest institutes of housing, Swedbank Hypotek. Moreover, Swedbank has substantial banking operations in the Baltic countries (Swedbank 2011).

Together these four banks have a strong position on the Swedish financial market; however the market shares differ between different sections of the market. For example, the market share for the four banks accounts is 75 % in terms of the Swedish deposits. As well as similarities, there are differences between the four banks mentioned above. The greatest differences are in the types of customers, pricing of services and distribution channels.



Even though these banks are often thought of as a group, because of their size, it is important to remember that they are competing not only with each other but also with the smaller banks on the market (Svenska Bankföreningen 2010).

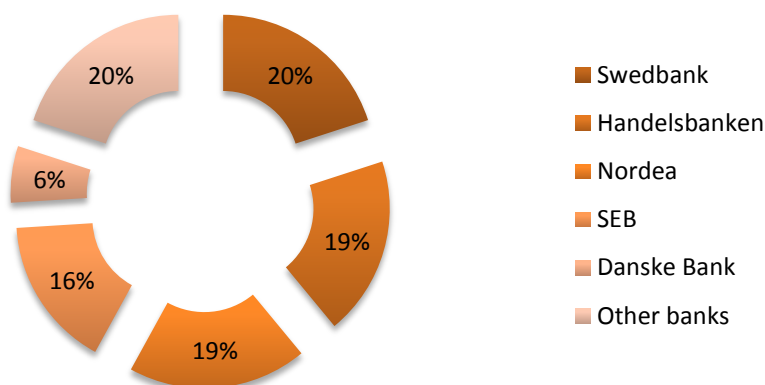


Figure 4: Share of Swedish Deposits 2010. Source: Svenska Bankföreningen 2010.

In addition to the four large banks, the financial market is home to other players, such as foreign banks, trustee banks and member banks, and during the last ten years, both niche banks and foreign branch offices has increased and gained market shares in Sweden. One member bank that differs from other banks on the market, and which is similar to the Islamic banking system, is JAK Medlemsbank.

JAK is run as a co-operative society and is built on the idea that the members deposit money so that it can be lent to other members without profit, meaning that the bank is able to offer interest-free lending, just as an Islamic bank. However, the two differ as lending in JAK requires fixed savings in relation to the loan from the borrower, and when the loan is paid for the member can withdraw this savings. In addition, the borrower must give security for the loan, for example through property, and pay a deposit as well as an administrative fee (JAK Medlemsbank 2011 A). Today, the bank has 36,000 members that all are equal owners of the society (JAK Medlemsbank 2011 B).

Furthermore, the two Nordic financial corporate groups, Danske Bank and Skandia, have entered the market, and succeeded to obtain a strong position. Many of the foreign companies have been able to get significant market shares in certain segments, for example in investment banking, and in total 117 different banks are represented in Sweden (Svenska Bankföreningen 2010).

### **Consumer behavior**

People's confidence for banks has been severely hurt by the global financial crisis and Sweden has lost most belief in the banks comparing to neighbor countries in Scandinavia (Svenska Dagbladet 2009). When the financial crisis was at its worst in 2009, the National Board for Consumer Complaints increased the amount of complaints with 16 % (Dagens Industri 2010). Another point that has led to even further doubt of the Swedish banks is the fact that high up managers in the banks industry have lately been paid high salaries and bonuses. The public feels that it is unfair and makes the relationship between customers and the banks less trustworthy. Since the crisis hit Sweden, bank clients have demonstrated that they want traditional banks to offer them simple and reliable products, customers are no longer interested in complex products (Svenska Dagbladet 2009). Consumers are also more skeptical towards banks and have become less loyal as they tend to swop among banks until they get the best price and offer. They also expect good treatment from the banks, so they can feel that they have a relationship with the bank (Dagens Nyheter 2010). As the Swedish banks are offering similar offers and rates, it's not the bank themselves who create the suspicion from clients, consumers in Sweden are heavily influenced by word-of-mouth activities, so when a bank starts to get a bad reputation it often spreads to others (Galijatovic, Höijer and Seldus 2009).

Swedish bank customers use more technological solutions when it comes to banking, such as the internet banking, Swedish banks are world leaders when it comes to offering their clients internet banking (Svenska Bankföreningen 2011 A). One more sign of a highly technical developed market in Sweden is that the use of online invoices increased by 34 % between the years of 2009 - 2010 (Svenska Bankföreningen 2011 B). However, most of the large Swedish banks have recently received complaints regarding their websites, security and on an impersonal way of doing business (E24 2010).

## 6. Analysis

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*From the macro and micro analysis above, four issues have been chosen that Islamic banks are believed to encounter when entering Sweden. These issues are Islamophobia, unfamiliarity, the number of players on the Swedish financial market and the Swedish legal financial framework. The issues will be elaborated and a suitable strategy on how to enter the Swedish market and how to market Islamic banking in the country will be adapted accordingly to each issue. These strategies will be based on the type of entry mode as well as on the marketing mix of a service.*

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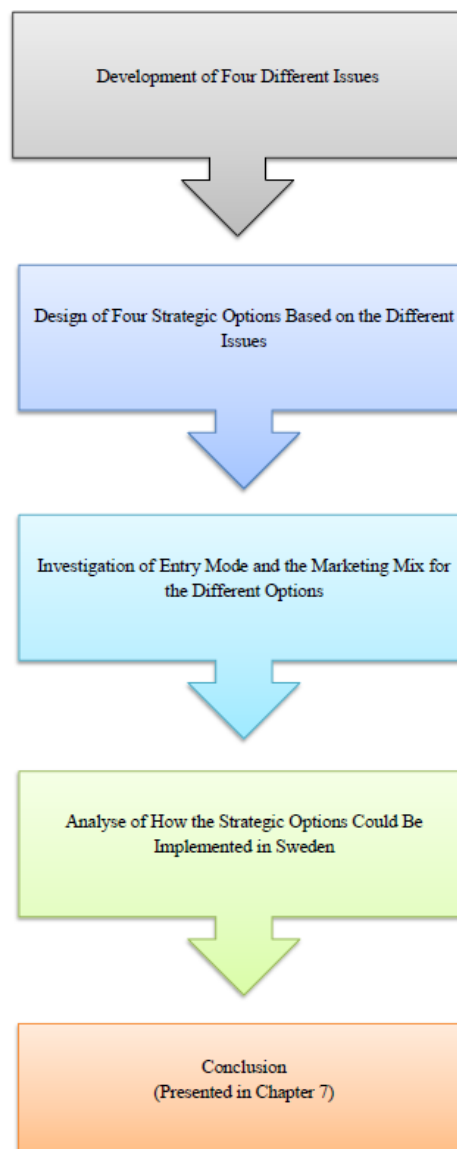


Figure 5: The Different Steps of the Analysis.

## 6.1 Issues

### Islamophobia

As mentioned earlier, the extreme right party Sverigedemokraterna is growing in tandem with the increasing Muslim population within the country. As mentioned before, the Swedish government therefore is undertaking an investigation of Islamophobia which shows how the phenomenon is rising in Sweden. This is something that is occurring, not solely in Sweden, but in several Western societies. Hence, Islamic banks may find it hard to become established on the Swedish financial market, as the name itself might scare people away. It could also result in that the system might be rejected without the public knowing the true meaning of it, and the consequence could thus be a niched clientele.

### Unfamiliarity

As no Islamic bank is established on the financial market in Sweden today, it can be considered as an unfamiliar way of doing business. Even though there is one bank on the Swedish market that provides interest-free banking, it differs in its approach, as explained in chapter 5. Thus, the public in Sweden is probably lacking the knowledge of the meaning of the Islamic financial system and as a result, Islamic banking might face the problems related to being a first-mover on a new market.

### Many players on the market

Since there are 117 different banks operating in the Swedish market, an Islamic bank that wishes to become established in the country will face fierce competition. Thus, Islamic banks have to focus on their competitive edge, which they can be considered to have due to their different way of running a financial operation in order to be able to compete with the already established banks in the Swedish market.

### Legal

As described in chapter 5, Islamic banking might be hard to adapt to the legal financial framework that exists in Sweden as until today. This means that an Islamic bank, when entering Sweden, has to choose whether it wants to conform to the existing legal framework

and thereby alter its concept so that it is suitable to the market, or it can find solutions to go around the laws and regulations, creating a Swedish version of Islamic banking to overcome the legal obstacles. That has been the case in Malaysia, where a local version of Islamic banking has developed, which differs slightly from Islamic banking in the Middle East.

## 6.2 Four Strategic Options

### Strategic Option 1: Islamophobia

#### *Entry Mode*

Since the Swedish market to some extent is characterised by the negative opinion related to the religion of Islam, as mentioned earlier, Islamic banks must consider which entry mode is the most suitable according to the current situation in the country. Thus, in order to avoid being connected with religion alone, Islamic banks could enter a joint venture with an already well-established Swedish bank, through the establishment of an Islamic Window. By doing so, Islamic banks could be able to wash away the negative connection to the religion as they operate under the other banks name, and thereby focus on marketing the attributes that their products possess. Thereby, an Islamic bank which enters the Swedish market through a joint venture can be considered to offer a 'light version' of the Islamic financial system with the introduction of an Islamic window, so that the market will get accustomed to the products and their specific features instead of connecting them to the religion.

According to Hill (2009) there are several advantages with joint ventures. First, companies entering a joint venture can benefit from the knowledge of the local partner in terms of the host country's culture, language, business systems and competitive conditions. This is probably the single most important benefit that Islamic banks can reap when collaborating with a Swedish bank, as they thereby can gain the knowledge needed for developing Islamic banking as an alternative in the financial market. Additionally, through a joint venture a company can lower the costs and risks that arise when entering a new foreign market, as it can share them with the local partner. This is of course beneficial for all types of companies, Islamic banks included, as it is optimal to lower the costs and risks but in this case it is presumably not the crucial feature.

At the same time, a joint venture has drawbacks which include the risk of losing control over technology to the local partner, the inability to engage in global strategic coordination and to

realise location and experience economies (Hill 2009). Due to the existing Islamophobia in Sweden, the knowledge and information that Islamic banks can gain about the market and the enhanced reputation it can acquire by operating under the local partner's name, there are reasons to believe that the advantages with a joint venture is outweighing the disadvantages.

As a joint venture is not a unilateral collaboration, which means that the Islamic banks that wish to enter this type of relation must find a local company that wants to partner with them. So what can an Islamic bank offer a Swedish partner? By cooperating with an Islamic bank, the partner could reach both a larger and a new customer segment. As mentioned in chapter 3, a lack of trust has developed for conventional banking, in Sweden as well as the rest of the Western world, and therefore a Swedish bank could enjoy the benefit of reaching a larger clientele by offering both conventional banking and Islamic banking through the Islamic window as it provides a safer alternative. Thus, the local partner could gain a competitive advantage against its rival in the financial market. Also mentioned in chapter 3, the Swedish Muslim population is growing, so by collaborating with an Islamic bank a Swedish counterpart will have the ability to attract a new customer segment by offering shari'a compliant products.

### *Product*

Thus, Islamic banking in Sweden can get a negative source of origin effect. Therefore, the Islamic banks could establish themselves in Sweden focusing on the positive attributes of the product offered, and compare this in a favorable way with other Swedish bank products (Gurhan-Cvanli and Maheswaran 2000). Some of the encouraging qualities the Islamic banks enjoy, which are not only appealing to Muslim customers are that the bank is a safer option, a more ethical choice, and is based on the building of the relationship between the bank and its customers.

As mentioned above Islamic banking might have a bad connotation to certain members of the public in Sweden, and therefore the bank should when developed and integrated as an Islamic window, use the Swedish bank brand name instead, to positioning itself as a part of a Swedish bank but with a different way of doing banking. Consequently the Islamic bank could take advantage of being in a joint venture as it then could compare the two different options and let the customer chose the most appealing preference.

From what is said above the bank will not adapt its product, as the bank believes this to be its competitive advantage, therefore the strategy is called straight product extension. Kotler, Wong, Saunders and Armstrong (2008) argue that this easy way can be successful if the business has a competitive advantage within its product over the other firms on the market.

### *Price*

One of the competitive aspects Islamic banks possess is that they do not use interest rates, instead using a penetration pricing strategy to attract new customers. Kotler et al. (2008), states that by setting a low price, the company will be able to penetrate and attract a wide range of new customers. There is simply more to gain for Swedish clients. However, it is a different way of conducting banking, which makes it central to promote an understanding of how the Islamic way works, in terms of pricing.

### *Place*

The Islamic bank should primarily be located where the co-operating Swedish bank are to be found as it is most suitable for adapting to existing channel structures when entering a new market (Kotler et al. 2008). Conversely it will be in a different section as pointed out in chapter 5, it is important that the Islamic bank's operations does not mix with the conventional approach given by the Swedish bank, as this is seen as *haram*. When the Islamic bank has established themselves and somewhat diminished the connection between Islam and the bank, and learnt more about the new market and its clients, then it would be suitable to establish their own branches in appropriate locations where their concentration of customers can be found.

### *Promotion*

As a result of the negative source of origin effect the bank should not promote themselves as Islamic, but instead as a new way of doing banking which originates from Islam, but is not only for Muslims, nonetheless for a new generation that are looking for new ways after, for example, the financial crisis.

In conjunction with the Swedish bank, the Islamic bank should develop advertising as it enables both banks to reach new markets. The new bank window will indeed draw attention

as a result of its advertised benefits, and will therefore take use of a pull strategy when attracting new clients (Kotler et al. 2008).

As Islam in general is a very up-to-date and frequently discussed in the news, magazines and debates, the development of an Islamic window will most certainly create dialogues, which will give the bank PR, and even if some of it might not be favorable, all publicity will lead to a rise in the awareness of the bank. Public relations are becoming increasingly important in Sweden and are a fast growing marketing tactic; therefore the Islamic bank will gain more exposure to the public (Johansson and Ottestig 2011).

### *People*

As this strategy is built upon the fact that the general public in Sweden has lately developed a phenomenon called Islamophobia, one way to overcome this issue is to hire non-Muslim staff. This in order to signalise to the public that the bank is not only niched to Muslim customers and that it is a local bank that emphasises Swedish values. The partner bank in the joint venture could possibly transfer some of its staff to the Islamic branch. This would create knowledge sharing within the two banks, helping the Islamic bank to overcome culture clashes and gain a deeper understanding of its clients' needs and demands in Sweden. The new staff will also be trained in customer service and satisfaction, and will initially create more loyal clients (Kotler et al. 2008).

### *Process*

Swedish customer attitudes towards banks have been severely hurt by the financial crisis and the public has lost trust in the financial institutions. Islamic banks puts emphasis on relationship marketing as mentioned in chapter 3, hence they use a customer oriented method to retain customers. They should for example make sure that a high customer satisfaction is put in place through long-term relationships, partnership, value-added products in terms of a 24/7 customer line, safety and other extras. Kotler et al. (2008, p. 387) points out the importance in today's society with the statement: *"Marketing is moving away from a focus on individual transactions and towards a focus on building value-laden relationships and marketing networks."*



### *Physical Evidence*

The Islamic bank window will be a new division in the joint venture; therefore a fresh and modern Scandinavian touch should be added to interior design. This will lead to even further promotion of the strategy of local adaptation that is preferable for the bank. As Islam might scare people off, no Arabic script should be used anywhere, only Swedish letters. Also the website should be adopted and developed accordingly to Nordic standards. This will communicate to the customer that the new division is a new modern bank which puts emphasis on its new client's values (Kotler et al. 2008).

### **Strategic Option 2: Unfamiliarity**

#### *Entry Mode*

Due to the fact that there is no Islamic bank operating on the Swedish financial market, an Islamic bank that enters this market must create awareness of its operations and products. This means that the Islamic bank to some extent needs to educate the public so that it will recognise the brand and the business model that it is based upon. It is this business model and the products that have been developed according to it that is the bank's competitive advantage, and to be able to keep control over this specific competence a desirable entering mode would be a wholly owned subsidiary. An Islamic bank that chose this strategy can either acquire an already existing Swedish company or start a new operation, thereby making a so-called greenfield investment (Hill 2009). In this case, a greenfield investment would be preferable since the bank should avoid adapting its operations to Swedish banking activities, as it then might forego its unique business model.

Other benefits with choosing this type of entering strategy are that it provides the company the control over its operations in different countries and enables it to realise location and experience economies. The strategy also means that the enterprise owns 100 % of the stock and thereby will receive the same share in the profits that are generated on the Swedish market. Just as with a joint venture, entering through a wholly owned subsidiary will have its disadvantages, and this type of entering mode is the most costly and risky method to use (Hill 2009). However, banks and financial institutions have the ability to develop economies of scale through operating as a global niche and thereby become leaders in the field. Niching can be accomplished by establishing a financial function that is being delivered better than the functions of the competitors (Gordon 2011). As an Islamic bank operating in several markets

around the globe enters the Swedish market, it will have the ability to enjoy the benefits that come with being a global niche bank, and thereby have the possibility to reap economies of scale.

Furthermore, an Islamic bank looking at entering the Swedish market could actually use the unfamiliarity surrounding the banking system to its advantage. By entering the market early, an Islamic bank could benefit from being a first-mover and benefit from the advantages that this brings. The early establishment could enable the bank to build a strong brand name which makes it harder for following competitors to gain market shares, and it could also result in the creation of switching costs that tie the clients to the first bank's services (Hill 2009).

### *Product*

This strategy is limited in the adaption to the current market, thus the product will not be changed, and thereby a straight product extension method is being used (Kotler et al. 2008). The strategy used is a differentiation strategy as the products the bank are offering have a high quality, uniqueness, and to add on more value to the core product it has special features such as a concierge service for its clients (Brassington and Pettitt 2006).

### *Price*

The bank should try to capture customers through offering different prices of its services; this will enable it to target different customers. By doing a target pricing strategy the bank is hoping to attract all types of customers. However as the bank is taking use of a differentiation strategy it will be certain that it is always giving its clients superior value for a given price. If the banks retain their consumers through loyalty, this could initially lead to customers who bought inexpensive services, will most likely advance to the use of a more costly service of them in the future (Caroll 2009).

To point out is that the Islamic bank is very selective when choosing its clients and therefore will not accept all clients if they cannot fulfill the banks standards, however this could lead to further interest for the public, as only some customers will be able to benefit from the banks extraordinary services.

### *Place*

The banks should be placed in central locations and high streets around Sweden. At first they will be located in the big cities such as Stockholm, Gothenburg and Malmö and the cities

surroundings, as most of the Swedish customers are centred there and it is easier to target clients. Additionally, according to the Swedish Central Bureau (2010), most of the Muslim population is situated in the larger cities and their surroundings; therefore it can be beneficial for the bank to be located in these areas as the Muslim community will be a customer segment of huge importance. When the bank has been established in the big cities it thereafter should launch themselves into other medium sized cities.

### *Promotion*

As the Islamic bank is hoping to slowly capture more and more of the non-Muslim community, it therefore needs to educate the public in what Islamic banking is and how it works. This is also believed to be necessary according to one of the interview respondents which states that the Swedish public should be educated about Islamic banking through learned scholars, so that there will be no misconception (Interview 5). It is vital to make the customer understand the services that Islamic banks offer, and how it differs in comparison to ordinary conventional banks, and what Swedish customers can gain by switching to an Islamic bank. This will primarily be made through public relations events, seminars, TV shows, advertising, magazines, and also concluded through a conference, described down below. There should be a heavy focus on advertising in different forms when first entering, Kotler et al. (2008) argues this is a push strategy, which can be beneficial when introducing a new service to a market.

Another aspect on how to introduce Islamic banking into Sweden was given by the interview subject *Pedro Garcia*, he suggested to organise a press conference, with Islamic scholars, the Swedish Financial Authority, and other experts in the field from all around the globe will be invited also (Interview 5).

### *People*

The bank should bring some of its staff from some of its other international branches, as their expertise in the field is highly valued. However, there should also be local staff hired, as the bank may encounter problems with the Swedish language otherwise. Another point the bank will use to promote its exclusiveness and to build on to its differentiation strategy is through making sure the staff have a high class, good phone manners, and are smart and moderate in

terms of apparel. This will certify the customer of a high quality in the bank's service (Wentzel 2009).

### *Process*

The focal point in Islamic banking is to insure the customer feel safe and secure with its services through a strong relationship. The bank should therefore put high emphasis on creating commitment and trust, and as figure 6 shows, this can be accomplished through shared values (e.g. in terms of religion and sustainability), benefits such as loyalty and good communication will initially lead to relationship marketing. By doing so the reliability and integrity of the bank will increase and this in turn can be symbolised by consistent, competent, fair, helpful and honest ways of doing banking for the customers of the bank as well as the general public (Morgan and Hunt 1994).

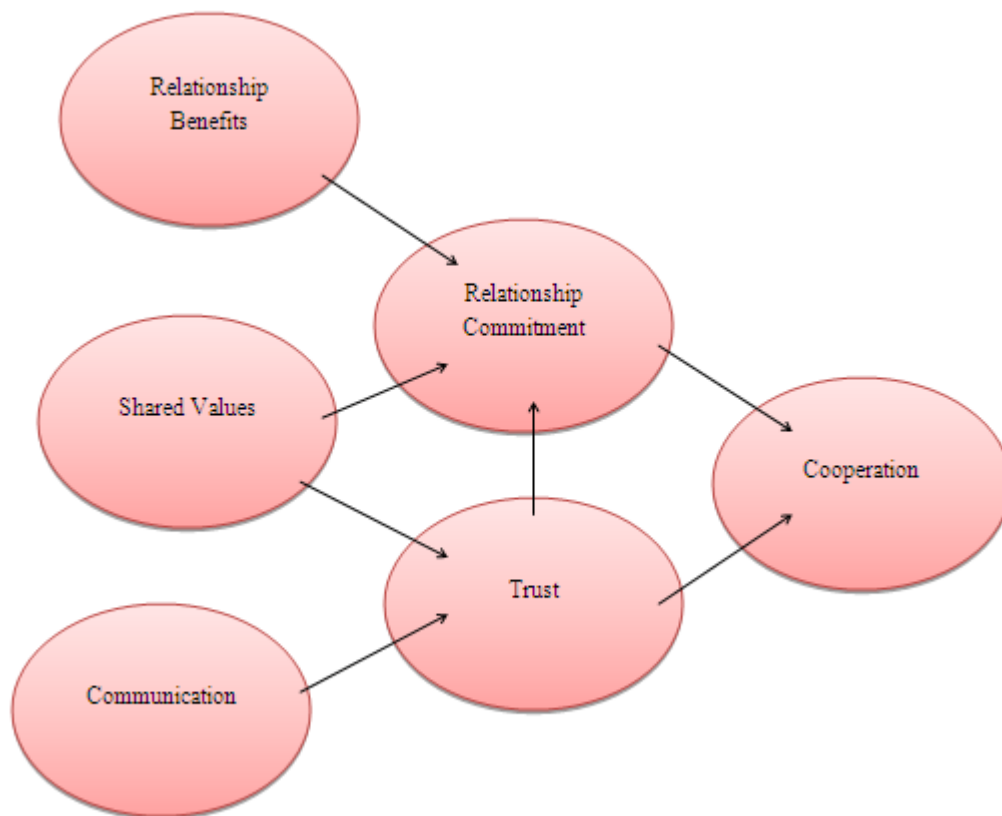


Figure 6: The Model of Relationship Marketing. Source: Morgan and Hunt 1994.

### *Physical Evidence*

No local revision should be made in terms of the location where the service will be given, the distribution channels physical appearance should be standardised meaning that it will be similar to other branch offices abroad (Kotler et al. 2008). Furthermore, the interior design should be influenced by Arabic standards. The building itself should be new and modern to show the exclusiveness of the bank's offered services.

### **Strategic Option 3: Many Players on the Swedish Market**

#### *Entry Mode*

The large number of banks operating in Sweden is a factor that an Islamic banking needs to take into consideration before entering this foreign market. Kim and Wang (1992) have stated that companies operating in an industry where there is a high concentration of competitors will benefit from choosing an entry mode that provides strong control, as it enables a company to ensure that the strategic actions of a subsidiary in another market will not have a negative impact on the other markets in which the company is operating. Furthermore, a high level of control will provide the company with the possibility to have the subsidiary in one market assist in the competition between rivals in another market, which in turn can benefit the overall organisation.

Hence with the fierce competition on the Swedish market, a wholly owned subsidiary could be the most suitable entry mode for an Islamic bank since one of the main advantages with this strategy is the large amount of control that it provides, as mentioned earlier. By entering the market through a subsidiary, the Islamic bank could use the possible experience it has from entering previous markets in order to build up a strong brand in Sweden that is able to compete with the already existing companies on the market.

As in the previous option, an Islamic bank that establishes a subsidiary on the Swedish market will also be able to retain control of its competitive advantage and products, which differs from the ones that are offered on the market today. However, in this case it can be more favorable for the bank to enter the market through acquiring Swedish banks, rather than establishing the subsidiary from scratch. Growth through acquisition could enhance an Islamic banks ability to rapidly become present on the new market, and by choosing this strategy it could gain a strong position towards other Islamic banks that will enter the market

in the future. In addition, an acquisition is considered to be less risky than a greenfield investment (Hill 2009). Thus, a strategy based on acquisitions may result in an Islamic bank succeeding on the Swedish market as it can gain market shares quickly and attract clients with its safer and more ethical products.

### *Product*

The Islamic bank possesses a competitive advantage that neither of the other banks in the Swedish market can offer, at least not to the same extent. Therefore the bank is able to compete with the other established banks. Its competitive advantage is built up in the way it offers banking, which is highly differentiated to the other players in the Swedish market. When using services from the Islamic bank the customer will automatically involve themselves in social responsibility and charity.

CSR and SRI are growing sections in the financial market and are increasingly gaining significance in today's society; the public have lately pointed out that the meaning of business is more important than the profit (Svenska Dagbladet 2010). As the public are searching for safer alternatives that provide the feeling of accomplishing something good and contributes to the creation of a more equal society, Islamic banks have the opportunity to meet these demands. Hence, conventional banks might face difficulties in terms of competing for customers.

### *Price*

As the price is not the main aspect in this strategy, the bank should not be competing in terms of pricing. The Islamic bank is confident in gaining clients through the products' special attributes, and thus it believes it is of insignificance whenever a high or low pricing strategy would be used. However, the bank's targeted segment should foremost contain people who pay attention to the creation of a sustainable future, meaning that the clientele can become broad as the customers can be from any social or income class. It will therefore be beneficial for the bank to offer a wide range of different services at diverse prices (Brennan, Baines, Garneau and Vos 2008). The client should also be able to have the possibility to choose, depending on their financial situation, if they want to be limited in the use of the bank's services and in that way create a more equal society, or if they want to be involved at a deeper level through charity schemes.

## *Place*

As in the previous strategic option, the bank should offer its services in larger cities at first and then when fully recognised move on to establish themselves in medium sized and smaller cities.

## *Promotion*

The target segment of the Islamic bank is considered to be a growing segment in Sweden and is likely to gain further growth in the next years. One way of promoting the new bank is through sponsorship of for example charity events and other actions for sustainability and equality. Olsen and Thjomoe (2009) states that sponsoring is a valuable asset when targeting a group of people with the same values. This can also create 'word of mouth' marketing. De Matos and Rossi (2008, p. 508) explains that *"there is a significant positive effect on loyalty and commitment to the brand when use of WOM activity"*.

## *People*

The staff of the bank should show a strong emphasis in their awareness of the importance of the products compatibility with the CSR standards, thus in order to promote the products the best way into the clients' minds.

## *Process*

Safety and sustainability should be two of the bank's key words. Every strategic decision that the bank decides upon should be determined according to these words that the bank follows. This will be published for the public, making them be able to follow the CSR approaches and the safety standards the bank practices. This will ensure the customers of the bank living up to its set standards.

## *Physical Evidence*

When entering the bank, there should be physical evidence of the safe and ethical methods that the bank is using and how it is working towards the creation of an equal society. This could be accomplished through, for example, visible banners and brochures stating the bank's awareness and safeness. All communication channels that is in line with the key words should be used to convey the attributes connected to the service such as the website and other sustainable ways to reach consumers.

## Strategic Option 4: The Legal Framework in Sweden

### *Entry Mode*

Due to the legal framework that exists in Sweden, there will be a few problems for an Islamic bank that wishes to operate in the financial market. As mentioned above, the bank in this case has two options: it can either choose to conform to the Swedish regulations and thereby renounce some of the values that Islamic banking is based upon and become more similar to a conventional bank, or it can find specific solutions to overcome the legal obstacles and thus maintain the values and principles of Islamic banking, developing a Swedish version that differs slightly from Islamic banks in other countries.

The latter of the two options would be the preferable choice, as it enables the bank to preserve the principles and values that are the core of Islamic banking, and which can also be seen as its principal competitive advantage, while operating on the Swedish market. Hence, the Islamic bank should develop solutions that have been adapted to both the regulations in the Swedish financial market as well as the regulations in Islamic finance. To accomplish this, an Islamic bank could enter a joint venture with a Swedish bank, which develops a banking sector that is entirely dedicated to Islamic banking. By doing so, the bank can enjoy the benefits that a joint venture brings, as mentioned earlier. Additionally, a joint venture can be beneficial for an Islamic bank, as this type of entry mode has been said to be favorable since the local partner may have the ability to influence the host government and its policies (Hill, Hwang and Kim 1990). Thus, the collaboration with a Swedish partner could mean that there is a possibility for the Islamic bank to influence the laws that are regulating the financial market in a long-term perspective, making it easier for the bank to operate accordingly to the Islamic regulations.

According to one of the interview respondents, Islamic banks that are acting internationally are adapting their business to the different countries in which they are operating, because of the varying interpretations of laws and regulations (Interview 2). Based on this, Islamic banks can be considered to pursue a multi-domestic strategy, which means that each market is believed to be different in regards of competitive conditions, operating conditions and political, legal and social structures. This gives the national subsidiaries a large degree of freedom, as they will function on their own to be able to adapt their operations to the different circumstances in each country. Thus, only a low degree of control is required for companies



using this type of strategy and therefore a joint venture can be a favorable entry mode (Hill et al. 1990).

Furthermore, an Islamic bank can use the knowledge that a national partner possesses about the market, and together they can develop suitable solutions for Islamic banking in Sweden. Thereby, the Swedish partner will have the ability to offer both conventional and Islamic, which can be seen as a reason for it to enter a joint venture with the Islamic bank, just as in the case of Islamophobia.

### *Product*

The bank needs to adapt its products to the Swedish legal environment; therefore it must find suitable solutions that are compatible in both a Swedish regulatory and a shari'a compliant perspective.

This means that the bank will have to restructure and adjust some of its services and products. For example, one problem the bank will encounter is that according to Swedish law, banks are not permitted to own property, something commonly used in Islamic banking. One solution to the difficulty would be licensing, this would be compliant with Islamic values and would not go against the Swedish legal framework.

### *Price*

An appropriate pricing strategy should be accustomed according to the Swedish macro and micro economic environment. Due to the joint venture, the bank should also take use of a similar pricing strategy that the Swedish conventional bank is using in order to compete with their competitors (Brassington and Pettitt 2006). By adapting to the Swedish partner's strategy, they will not come across problems regarding taxation, as they will follow the other bank's way of pricing.

### *Place*

The Islamic bank should incorporate its business into the business of the national partner, however it should not be an Islamic window, but instead a separate section offering Islamic banking. Therefore the distribution channels will be interlaced. Furthermore, the Islamic bank should only offer its way of doing banking at the larger branches of the partner bank to start, this due to the complexity of being a new bank on the market.

### *Promotion*

The Islamic bank should develop promotion material and PR events together with the Swedish partner bank, thus this will further endorse that the bank is entirely committed to living up to the Swedish laws and standards.

### *People*

One of the legal issues the bank may encounter is concerning the people working for the Islamic bank. The sharia'a board consisting of religious advisers has to participate in the Swedish Financial Supervisory Authority's customary management assessment. Therefore Sweden will develop its own type of sharia'a board which will be acclimated to the laws, values and beliefs of Sweden (Interview 5).

### *Process*

The Islamic bank should evolve a new way and process of conducting Islamic banking, which has been fully adapted and specialised for the Swedish legal environment. Hence, the banks process should be fully compatible with the Swedish market. As mentioned in the previous topic, all of the religious advisers as well as the management team should undergo the Swedish Financial Supervisory Authority customary management assessment.

### *Physical Evidence*

The banking will be offered inside the other bank's branches, however in a separate section as mentioned above; consequently the Islamic bank will therefore give the same message to its clients as the partner banks give in terms of physical evidence. The Islamic bank believes that by being in the same physical environment as the Swedish bank, the bank can indicate that it is fully familiarised to Swedish values and laws (Brennan et al. 2008).

The Islamic bank's website will be interlinked to the Swedish partners, this in order to create the same physical image throughout its communication channels to the customer.

## 7. Conclusions and Recommendations

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*This chapter provides the conclusions which are based on the findings in the analysis. This is followed by recommendations for an Islamic bank that wishes to become established in the Swedish financial market and the chapter ends with a few suggestions of suitable subjects for future research.*

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### 7.1 Conclusions

Islamic banking is an interesting subject to study as it, with its interest-free principles and religious based values, differs greatly from conventional banking. Even though Islamic banking is said to be a safer and more human alternative, conventional banking is still in majority in the financial markets around the world.

This study proves that Islamic banking comes in varying forms depending on the specific environment of each market. Malaysia is a country where Islamic banking has become a success and the country can be seen as a role model for how to implement this financial system alongside of the conventional. The country has managed to demonstrate that the use of one financial system does not have to exclude the establishment of another.

Furthermore, the successful implementation of Islamic banking in Malaysia is believed to be an ideal example for Sweden to emulate as it can be helpful in providing the answers to the issues Islamic banks will face when entering the Swedish financial market. Malaysia's alternative on Islamic banking is desirable due to the open and tolerant features that it possesses. These prosperous characteristics are considered to be a necessity for Sweden to seize. However, the most important aspect for Sweden to acknowledge is that a way of doing Islamic banking, specifically adapted to the circumstances in the Swedish financial market, must be developed.

As conventional banking is deeply rooted in Sweden, a dual system must be developed in order to implement Islamic banking successfully. Islamic banking will never become larger than conventional banking and will therefore never be able to exclude conventional banking from the financial market; instead Islamic banking should rather be seen as a complement to conventional banking and as an alternative for the Swedish consumers. There should not be a problem to develop a dual system in Sweden as long as it is adjusted to the financial market and its characteristics, as in the case of Malaysia. The implementation of a dual system will

also be beneficial for the Swedish consumers as it provides them with options in terms of new banks and financial products. By having the two systems working parallel to each other it can also mean that the effectiveness as well as the services and products will improve as competition will increase within the country. What could also happen is that a company sees a gap in the Swedish market and develops a bank that is based upon the concept of Islamic banking, where the same methods are used and the ethical features are used, but it is not connected to Islam as a religion. Either way, it will be advantageous for the Swedish public in the end.

Islamic finance is an industry that is intriguing from an international business perspective as there is an immense need for alteration among different countries. Thus, an Islamic bank cannot neglect the local conditions; instead it must find a strategy based on adaptation and localisation in order to become established and gain market shares in new regions.

Even though the four different issues, developed in chapter 7, have been examined separately in this study, an Islamic bank entering Sweden needs to take into consideration that it will encounter all of these problems. Therefore, the bank must analyse the issues together in order to evaluate the significance of them and how it afflicts the bank's strategy in terms of how to enter the Swedish market and how to market itself to attract customers. Regardless of how the bank chooses to focus on the different issues it has to recognise the current conditions in the financial market and adapt its operations accordingly.

The conducted interviews have proved that Islamic banking is a great alternative for both Muslims and non-Muslims and appeals to all people regardless of their religion. The interviews have also provided a deeper insight and understanding of Islamic banking as a whole as well as Islam as a religion. During this study the knowledge about Islamic banking has improved and also has the positive view of Islamic banking as a financial system. Thus, it is believed that if the knowledge about Islamic banking will increase in Sweden, the financial system might be perceived positively by the public and thereby become a growing and popular segment in the Swedish market. Furthermore, knowledge and information is believed to be the key to making Islamic banking a success in Sweden.

The findings in this study also show that there is no real reason for an Islamic bank not to enter the Swedish market, as the obstacles it faces can be overcome through use of research and development. By doing so, the bank has much to gain as it can become the first bank to

establish the Islamic banking system in the market. Due to current effects of globalisation, such as multiculturalism, the movement of people and the increase of ethnical and sustainable awareness, it is inevitable that a Western society like Sweden will not develop a banking system built upon Islamic standards. This belief is also shared with one of the interview respondents who stated that Islamic banking will play a major role in the future, and that even the Vatican thinks that Islamic banking could help save the trust for banks (Interview 3). Therefore it is highly relevant for players in the Islamic financial industry to consider entering Sweden, as it will be a beneficial investment in a long-term perspective as the world is believed to be moving towards Islamic banking.

## **7.2 Recommendations**

The recommendations have been made to the players of Islamic banking that wish to become established in the Swedish financial market.

As several advantages are stated to be related to the entrance into the Swedish market, it is argued that an Islamic bank should seize the opportunity and establish itself in the country before rival takes the chance. The belief is that an Islamic bank could constitute a good alternative to the existing conventional banks due to the recent increase in demand for ethical and sustainable financial products and the lack of trust for the traditional banking system.

In order to implement Islamic banking successfully in Sweden, the bank must be prepared to focus heavily on research and development in order to learn how the local market functions, and to develop a strategy that is suitable for it.

## **7.3 Future Research**

During one of the interviews, an interesting discussion of the other financial products that Islamic banks offer took place. The Islamic financial system contains several different products and is not solely concentrated on pure banking activities. Thus, to study other Islamic financial products and their transferability to Western countries could be a suitable topic for future research.

From a marketing perspective, future research could include investigating the Swedish consumers' attitudes towards Islamic banking, whereby one of the main questions could be to examine if clients are more open towards this type of financial system if it was not connected

to the word Islamic. This could be an interesting subject due to the increasing Islamophobia in Sweden and the entrance of the extreme right hand party into the parliament.

# List of Interviews

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## Interview 1

This interview was conducted with David Lantz at his office at the Swedish Trade Council in Kuala Lumpur. For the interview in its whole, see appendix B.

## Interview 2

This interview was conducted with Hairuddin Majid and Zalikha Mazli, which are both working as guides at the Mosque Negara in Kuala Lumpur. For the interview in its whole, see appendix C.

## Interview 3

This interview was conducted with Abhinash Murukesvan at Svenska Handelsbanken's branch office in Kuala Lumpur. For the interview in its whole, see appendix D.

## Interview 4

This interview was conducted with a spokesperson for the organisation World Islamic Mint named Haji Awaludin at his mansion in Bangsar, Kuala Lumpur. For the interview in its whole, see appendix E.

## Interview 5

This interview was conducted with Pedro Garcia, who has worked for both conventional and Islamic banks. The interview took place at a restaurant in Kuala Lumpur. For the interview in its whole, see appendix F.

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# Appendix A

## Interview Guide

1. Islamic Banking, is that an accepted expression to use?
2. What do you think the main differences are between Islamic and conventional banking in Malaysia?
3. Have the two systems had any effect on each other, is there really a distinct difference or are the two becoming alike?
4. Does the Islamic banking system differ greatly between Muslim countries?
5. How do the cultural differences affect the financial system in Malaysia (considering the fact that the Malaysian population is constituted by three major ethnic groups)?
6. How is the Islamic banking system financed, is it through governmental support?
7. How do companies which are engaged in Islamic banking handle profits?
8. How is competitiveness developed in Islamic banking, how do companies gain market shares without the ability to compete with interest?
9. Is there a general legal framework for all companies engaged in Islamic banking and how is the banking system affected by legal frameworks in Malaysia?

# Appendix B

## Interview with David Lantz at the Swedish Trade Council 15<sup>th</sup> of March 2011

**David:** Actually, my knowledge of Islamic banks is very limited, and I hardly know anyone who uses their services. However I can give you an overview of Malaysia as a country.

**Yasmine & Linnéa:** Ok, then we will focus on asking more general questions about Malaysia rather than about Islamic banking. Could you please tell us from a PESTLE perspective about Malaysia as a country?

**David:** To start with political factors, Malaysia is by definition an Islamic state. However only 50% are Muslims, but Islam is the biggest religion. There are other large ethnic groups, for example the Chinese.

Within the business sector the Chinese are strongly represented, as the business world is not suitable for many of the Islamic values.

But the 2020 concept points out that all large different ethnical groups shall be presented in businesses for it to be political correct.

Islam is important according to the 2020 vision, however not as vital as it would like to appear.

The political parties rule the media, and they can't criticise the government, they have to be very cautious in their writing, and their text has to be accepted before publishing.

AMNO is the government party, which consists of several different parties, and the opposition is also composed by different parties. The ruling party have a lot of plans, however a lot of them will never happen, for example a lot of building projects that never get finished. They often have great ideas but they are rarely followed up. Many people believe there will be a new election this autumn.

Another aspect in the political environment is that Malaysia is one of the few countries in the world that is protecting one ethnical group, therefore there is some tension, but there is too

little action from the other ethnical groups for a protest or riot to actually happen. This dates back to when the British colonised Malaysia, as they are supposed to have put this system in place.

**Yasmine & Linnéa:** What about the economic situation, was Malaysia affected by the financial crisis, etc.?

**David:** They managed the crisis relatively well, as their market is protected and they possess a lot of natural resources.

In the 70's they were one of the 'Asian Tigers', compared to other countries in the area, Malaysia was very rich, this due to its natural resources, such as oil, palm oil etc.

Even though Malaysia was rich, they are today behind many of the other 'Asian Tigers', which have managed to move forward into developed countries. Malaysia can't add any value; they are stuck in a middle income trap, which they are trying to get out of with help from a new 5 year plan that the government has developed. I believe they have to create more value; they can't afford living on their natural resources and need to find new innovative solutions; change would be good for them.

Islam does not have a great impact in the economic environment as they are not fundamental Muslims. There are different rules for foreign businesses, these companies are welcomed and treated well. However when a foreign business establishes themselves there is a quota system; they have to have local staff in their companies.

Something that could be harmful to the Malaysia economy is 'Brain-Drain', which implies that many young people study in Malaysia but after graduation they move to other countries.

When doing business in Malaysia it is important to be buddies, you need to build relationships with the people you are doing business with. First when you have managed to establish a relationship you can make them sign something.

**Yasmine & Linnéa:** If looking at the social atmosphere in Malaysia, is there a clear upper class and how important are the different religions?

**David:** Most families live on around 3000 RM a month, equal to around 6000 kr in Sweden. However this is something you can't see in Kuala Lumpur, the numbers exist in the statistics but personally I don't see it.

Religion is important; you have to believe in something, Malaysia has relations with certain countries in the world that Sweden doesn't even accept as countries, this due to their religion, Islam. Also Malaysia has become a hub for banking, there is even a saving scheme aimed to save up to go for a trip to Mecca.

In Malaysia the technology has rapidly advanced, and is rising, they are looking for innovations abroad. They are moving in the right direction; however there are large differences in the cities and in the countryside. The government has monopoly on internet, this prevents the development, and this is a huge problem for foreign businesses.

In terms of the legal system, it's based on British common law.

There are a lot of environmental issues, they are destroying a lot of the rain forest, but it is controlled and can't be compared to countries like Indonesia. They are trying to build green buildings. Corporate Social Responsibility is good but of course not as good as back in Sweden.

# Appendix C

## Interview with Hairuddin Majid & Zalikha Mazli at Mosque Negara 15<sup>th</sup> March 2011

**Yasmine & Linnéa:** Tell us about Islamic Banking?

**Hairuddin:** Banking in Islam deals with gold and silver, this is written in the holy book. In Islam everything must be based on the Qur'an, from the first word to the last. Paper money was brought by the Americans, and interest rate came from Jews.

In Islam it is important that you work for yourself and not to gain from the losses of others. Haram is prohibited and halal is accepted. Islam is a religion on knowledge, the source is the Qur'an and Hadith, which is the recorded version of the prophets actions. Islam is a religion of advice and reminiscence.

**Zalikha:** Interest rates come in many forms, Allah calls it riba. Allah also states that “Whoever eats of usury becomes the flesh and blood meant only for the hell fire. If you know it, take your capital and leave. If you don't know, you won't get judged.” Islam is a mission and Muslims are those who submit. Everyone is born as a Muslim. Not judged from birth to puberty, since we don't know right from wrong. The Qur'an confirms what was in the previous books, such as the Torah.

**Hairuddin:** There is a question mark about conventional banking, that's the reason for Islamic banking. Interest rates are unfair; in Islamic banking you take the riba out and give it to public reparation and other good causes. It is your own conscience that decides what to do with the riba. When you die, every part of you will have to answer to Allah – what you have done. Muslims who use conventional banking will be questioned.

When borrowing from an Islamic bank, they want to know what your occupation is. In conventional banking it doesn't matter. In Islamic banking everything has to be pure. You won't be able to get an account in an Islamic bank if you're not pure.

Islamic banking is the lesser of two evils, before the gold and silver trade can come back. In Kelantan, an Islamic state in Malaysia has come up with Dinar and Dirham trade.

**Zalikha:** Every Muslim follows different imams – a universal model would be preferred, whereas everyone is following the same imam. From a man and female Allah created nation and tribes so one would know each other and accept everyone. In Islam you look at the true believers and the true followers. You will be questioned when you die. When you do prohibited things you are not a Muslim anymore.

**Yasmine & Linnéa:** How does it work for the Islamic bank to be interest free?

**Hairuddin:** An Islamic bank offer similar services and products as conventional banking; loans, trade financing, deposits such as current accounts, savings accounts and fixed accounts. However, in conventional banks all these products are based on interest rates, whereas in Islamic banking we use profit-and-loss sharing. So every profit that can be derived from every single one of the bank's products must be shared between the bank and the client. For example, say that I put 100 RM on a savings account and by the end of the year I have a balance of 110. Then I have made a profit of 10 RM which I have to share with the bank. This profit can be shared differently depending on each customer. This ratio is agreed upon between you and the bank and it can be 50:50, 60:40 or 70:30.

**Yasmine & Linnéa:** Is the mosque and Islamic banks sponsored by the government?

**Hairuddin:** Yes, both the mosque and the Islamic banks are sponsored by the government.

**Yasmine & Linnéa:** How does Islamic banking in Malaysia differ from other countries where the method is being practiced?

**Hairuddin:** In the Middle East they think the Malaysian window system is haram and they disagree with it. Either they use an annuity table or they call it differently. In Malaysia it's mandatory for the banks to offer Islamic banking, so it is up to the customers to choose, this is not the case for most other countries.

# Appendix D

## Interview with Abhinash Murukesvan at Handelsbanken 17<sup>th</sup> of March 2011

**Yasmine & Linnéa:** What do you think the main differences are between Islamic and conventional banking in Malaysia?

**Abhinash:** Islamic banking in Malaysia dates back to the 60's. The segments true growth came in the mid 80's with a purpose to cater to the needs of the Muslim population. Sharia'h compliant products have since proven to be attractive to both Malaysia's Muslim and non-Muslim population. The dual system in Malaysia has made comparisons between conventional and Islamic products possible, and also introduced it to a new and unintended consumer/corporate markets. The main difference is that in Islamic finance, the Sharia'h principles are fundamental. The fundamental philosophy is to meet the financial needs of participants with integrity and in a manner that is just, fair, trustworthy and honest.

**Yasmine & Linnéa:** Does the Islamic banking system differ greatly between Muslim countries?

**Abhinash:** There is no uniform definition of Islamic banking thus far. Global standards are needed to harmonise the heterogeneous industry. This is the result of different Islamic schools of jurisprudence or financial needs in different countries.

**Yasmine & Linnéa:** How do the cultural differences affect the financial system in Malaysia (considering the fact that the Malaysian population is constituted by three major ethnic groups)?

**Abhinash:** Malaysia has a dual system in which both conventional and Islamic finance exists. Islamic financial products are open to the different races and religious groups in Malaysia. Non-Muslims have found the Sharia'h compliant service fairer than traditional banking. Many of the larger Islamic financial institutions in Malaysia have borrower/deposit ratios from non-Muslims well above 30 per cent.

**Yasmine & Linnéa:** How is the Islamic banking system financed? Is it supported by the government? Are there differences between companies and countries?

**Abhinash:** Islamic institutions enjoy the same government support as conventional financial institutions. A popular form of funding is through the issuance of sukuk's (bonds). Malaysia issued the first global sovereign sukuk back in 2002. Since then Malaysia has been considered one of the pioneers of sukuk origination. At the end of 2008, 61 % of the total global sukuk market originated from Malaysia.

**Yasmine & Linnéa:** How is competitiveness developed in Islamic banking? How do companies gain market shares without the ability to compete with interest?

**Abhinash:** Growth in Islamic banking has been attributed to the retail customers' needs of financial products compliant with their personal beliefs. The products were initially not as competitive as those of the conventional kind. The increase of wealth in the Muslim world has spurred a demand for Sharia'h compliant products. On the supply side, more financial institutions offer Islamic products. This has yielded in more competitive intensity in the sector. For instance, the terms can in some cases be better than that on conventional loans. However, interest rates are not the sole competitive edge in Islamic finance; the Sharia'h principles mentioned earlier have proven to be universal and appealing even to conventional customers.

**Yasmine & Linnéa:** Is there a general legal framework for all companies engaged in Islamic banking? How is the banking system affected by legal frameworks in Malaysia?

**Abhinash:** The banking and insurance sector is regulated by Bank Negara Malaysia (BNM) whilst the Capital Market is under the Securities Commission (SC). In the dual system, BNM and SC have dedicated Sharia'h Advisory Councils. These councils examine and endorse the validity of Islamic financial products. The council consists of Sharia'h scholars that have background and experience in the application of Sharia'h in banking, finance, economics and law.

**Yasmine & Linnéa:** Have the two systems had any effect on each other? Is there really a distinct difference or are the two becoming alike? Has a native system developed?



**Abhinash:** The number of Sharia'h compliant products evolved to cover the needs of the consumer. There are similar conventional products as both exist based on market requirement.

**Yasmine & Linnéa:** Do you have anything else to add onto when it comes to Islamic banking? For example if it works in a country like Sweden?

**Abhinash:** I believe that Islamic banking will play a major role in the future, even the Vatican has said that Islamic Banking could help save the trust for banks. I think that Islamic Banking could work well as a concept in Sweden. I know Scandinavian banks are interested, however the Nordic countries work very little with the Middle East.

All countries can't have a dual system, for example it's not acceptable to have an Islamic window in Indonesia for example.

Something to add is that in Malaysia there is a large problem with the harmonisation of the Islamic banks, as there are different Sharia'h boards and different types of Islam.

# Appendix E

## Interview with Haji Awaludin at Bangsar, Kuala Lumpur 23th of March

*Haji strongly objected to use the questions we had prepared; instead he wanted to tell us about the World Islamic Mint and his opinion about banks in general.*

**Yasmine & Linnéa:** What do you think of Islamic banking?

**Haji:** I think that Islamic banking is more evil than conventional banking, both ways are Haram. I also think Bank Negara is a great robber. Muslims who uses Islamic banking are cheating themselves, its usury and they will end up in hell if they are aware about what they are doing.

Just because it is called Islamic banking doesn't make it Halal.

However, Muslims around the globe has started to realise the evil with Islamic banking, and one Scottish man has lately been pushing this development away from conventional banks, it took a western person to get people to realise that banks are Satan's work. Now we have to choose a functioning Muslim community.

**Yasmine & Linnéa:** So what is the World Islamic Mint, what is for example a Dirham?

**Haji:** The World Islamic Mint is built on Islamic tradition to exchange goods and not paper money. This originates from the five pillars. Gold has been used as money for about 5,000 years, and the Islamic way of doing has existed for about 1,400 years. The dinar was being used until 1922, after this the west way of trading with paper money took over.

In Islam there are no taxes, and in Islam gold, silver, wheat, barley, salt and dates is used instead of paper money. Poor and rich are all meeting at a common market place to trade these goods. Any commodity is accepted in Islam, you are free to choose. However, trading without money is difficult, but Allah came up with new ways of doing it in forms of dinar coins.

The gold coins standards are created by the ruler, therefore no one can cheat. One dirham is 7/10 of a mistcall, which weights nearly three grams. It is regulated; one standard mistcall is 72 seats of barley in weight. One Dirham is 24 Malaysian Ringgit, you can check how much it is worth on our website.

The most important thing about the World Islamic Mint is the fact that 1 dinar is worth the same as it was hundreds of years ago, you can for example buy a goat for the same price, there is no inflation. What you see is what you get.

Dinar and Dirham are my weapons; I will fight from my heart to tell the world. If you are clever start using gold and silver to trade, because the end will come when gold prices become very high. The prices of gold are rapidly increasing, it's like a Tsunami, and it will happen so fast people won't realise it, and the warnings will come too late; but if you have gold and silver you will survive, people need to start saving now!

**Yasmine & Linnéa:** Tell us the history about World Islamic Mint?

**Haji:** In the 17<sup>th</sup> century the gold standard existed, no paper money occurred. This was as a result of religious aspects, in Christianity, Islam and Judaism, interest rates were forbidden. Protestants were pointing out that paper money is bad and should not be taken into use. All big religions were against interest rates as it is stated in the holy books, but the Jews introduced conventional banks anyway; however it took Muslims around 37 years to accept it.

The west has destroyed the world, Obama was going to make a change, and instead he just printed more and more paper money. America is getting richer due to this meanwhile Africa for example is losing out. We need to become independent, as long as there is paper money we are controlled by the USA, when they cough we suffer in the back. All prices around the globe are going up, oil, chicken...

Today all countries have dollars as reserves, we are totally depending on them. Malaysia gives the USA oil and rubber, and they gives us paper money, my grandchildren will think I am completely stupid...

Today there is three times as much paper money as gold. The world has become slaves to the system, it is daylight robbery. Most people live in slums, and the gap is becoming bigger and bigger. Many of these countries are third world Muslim countries, unfair!

The western world and Islam world is completely different, for example a Honda to Mercedes key doesn't work because the size is different; Islam and non-Islam is not compatible.

Follow one Allah go to paradise, follow capitalism and go to hell!

# Appendix F

## Interview with Pedro Garcia at El Meson Restaurant 24<sup>th</sup> of March 2011

**Yasmine & Linnéa:** Is Islamic banking an accepted expression?

**Pedro:** The only country I know where it is not accepted is Saudi Arabia; but anywhere else, it is the term used and it is totally okay. If the expression would not be used it would confuse people, and we do not want that.

**Yasmine & Linnéa:** Could you describe the background of Islamic banking?

**Pedro:** Just let me start with saying that in the religion of Islam, the surplus of one person's wealth should be used to help those who need money. Within the Muslim community they help each other out. This belief is what has been transferred to the Islamic banking system, where the bank is said to be investing in people instead of just lending them money. By doing so the bank and the client participates in a partnership with equal profit sharing, meaning that they share the profits between them. This is what the Islamic world believes in.

In Islam, there is a prohibition of *riba*, which means interest, and the punishment for being involved in *riba* is higher than it is for killing according to the Qur'an. In conventional banking, the use of interest means that the entire burden is on only one person, the borrower.

40 – 50 years ago, Islamic banking did not exist, it was only conventional banking. Islamic banking was developed only 30 years ago, foremost here in Malaysia. Malaysia developed the financial system and began exporting it to the Middle East where many conventional banks were operating. The Malaysian central bank quickly realised the potential in developing Islamic banking, and saw the possibility to create a financial centre in Malaysia, and therefore has spent a lot of money on this.

**Yasmine & Linnéa:** Does the Islamic banking system differ between Muslim countries?

**Pedro:** The difference and the challenge lie within the interpretation of different laws and regulations. It is the shari'a board that has to approve everything that an Islamic bank does, and every bank has its own supervisory board which makes its own interpretation. So the bank and its board do different interpretations from country to country, and Islamic banking is

therefore not the same in all countries. It is not the banking system that alters between countries, it is the interpretation of laws that differs heavily.

**Yasmine & Linnéa:** Is there a general legal framework for all companies engaged in Islamic banking? How is the banking system affected by legal frameworks in Malaysia?

**Pedro:** Islamic banks are regulated in mainly two ways, one being through BASEL just as conventional banks and the other being through a certain system that has been developed just for Islamic banks. Also, in Malaysia there is an additional framework that regulates the Islamic banks.

**Yasmine & Linnéa:** How is the Islamic banking system financed? Is it supported by the government? Are there differences between companies and countries?

**Pedro:** The government will not sponsor Islamic banks in any way, but what the Malaysian government does is that it makes it very easy for Islamic banks to become established in the country. An Islamic bank will get its approval right away.

Bank Negara gives out licenses that are needed before establishing a bank in Malaysia, and for conventional banks these licenses are much harder to get. In comparison, it is easier to get the license for an Islamic bank, as the government wants this sector to grow. Therefore, almost anyone can open up an Islamic bank in Malaysia.

The Muslim world is very wealthy, and much of the Islamic money is placed in Malaysia. It is the Middle East that has the money, but Malaysia is more advanced when it comes to Islamic finance and it is because of this that the government has been putting a lot of effort in developing Islamic finance. Therefore, the goal of making Islamic banks count for 40 % has become important and that is why the government facilitates the process for Islamic banks.

**Yasmine & Linnéa:** Could a person that is non-Muslim establish an Islamic bank?

**Pedro:** As a non-Muslim you can open up this type of business, but it is easier to be seen as trustworthy if you are a Muslim. Just like it is easier for a Spanish person to open up a Spanish restaurant. The bank can also hire non-Muslims; the religion of the employees does not matter.

**Yasmine & Linnéa:** Have the cultural differences that exist in Malaysia had any effects on the financial system?

**Pedro:** It has affected the financial system in the way that the government is focusing heavily on Islamic banking and wants to increase the Islamic banks to 40 % by 2020. Today it is about 16%. The government wants it to grow a lot but it is a slow transition. The population does not grasp it as fast as the government may like, since many people are struggling with the dilemma of wanting something really cheap, as they will get with conventional banking, but at the same time they want to stay true to their religion, they want to be good Muslims. Unfortunately, many go for the best deal even if it means that they are committing a sin.

**Yasmine & Linnéa:** So interest is forbidden, but how about profits?

**Pedro:** Profit is not prohibited. The calculation of profits is simple, as the bank calculates the profit and then distributes it between them and the client, for example 50:50 or 60:40.

**Yasmine & Linnéa:** What is haram then?

**Pedro:** Haram is for example, pork, drugs including alcohol, prostitution and gambling. This is why speculation within finance is not allowed as it is seen as gambling.

**Yasmine & Linnéa:** What else is different between Islamic and conventional banking, besides interest and profit sharing?

**Pedro:** One thing that differs greatly is the risk management, which in conventional banks is very straight forward. This is different in Islamic banking. Lending is the biggest risk for Islamic banks, since every loan is seen as an investment from the bank. This means that the bank cannot let its clients down, instead the bank will have to analyse what went wrong and learn to make wiser decisions. Because of this, the bank could never sue a client for not being able to pay back; the money cannot be demanded from the client if the person is having financial problems. Therefore, Islamic banks are very cautious as they lend money to their clients; they always go for safe bets. So for the client, Islamic banking is a much safer option. One can say that the clients of Islamic banks are much more covered and almost have a guarantee that is depending on their financial situation. However, if the bank finds out that the clients have been deceiving and mislead the bank by engaging in business that is haram, it is a

different story. Then the bank has the right to undertake legal actions in order to get the money back.

**Yasmine & Linnéa:** How do Islamic banks compete? How do they gain market shares without the ability to compete with interest?

**Pedro:** Well, they cannot really compete with the conventional banks. What will make consumers choose an Islamic bank over a conventional is the fact that it is more human. By using an Islamic bank the clients will be able to sleep better at night since the intentions of the system are good, it is the right way to think. An Islamic bank is engaged in charity since no brother should be poor and everything that the bank is engaged in is pure, meaning it is halal. Let me put it this way, Islamic banking is simply a more human alternative. The Islamic banks offer more human products and it is with these products that they can compete with conventional banks.

**Yasmine & Linnéa:** What is the role of Bank Negara in Malaysia? Is it regulating both the conventional banks as well as the Islamic banks?

**Pedro:** Bank Negara has two roles, it is not just the issuing monetary institutions, and it is also the regulatory for both conventional and Islamic banks. One of the main aspects in the Asian central banks is to regulate the flow of money, therefore the central banks operates under very strict and controlling regulations.

**Yasmine & Linnéa:** If you would like to promote Islamic banking in Sweden, do you have any ideas on how do it?

**Pedro:** First of all you should have a conference, where the minister of Finance should be present, also experts in Islamic banking should attend. This event could be sponsored by the Middle East. Conferences like this to promote Islamic banking has successfully been done before in, for example, Australia and the UK.

However, one of the main aspects for Islamic banks operating in Sweden would be to change the legal environment. The Swedish central bank would have to create a new department for Islamic banking. This would be easy to organise, however the political scene would have to



approve of this. You could also create a licensing department for Islamic banking, maybe and Islamic window would be a good idea.

**Yasmine & Linnéa:** Do you believe there is a potential market for Islamic banking in Sweden?

**Pedro:** To start with a market study should be conducted, to clearly see how big the market in Sweden is. However, I do believe there is a market for Islamic banking in Sweden. There are probably already some Islamic products on the Swedish market, and most likely some banks that operates in Sweden with Islamic banking offices abroad.

As said earlier, if conducting a conference, you could for example show and promote Malaysia as a case study to demonstrate how Islamic banking can work alongside with conventional banking. Another aspect I believe is to educate the public in Sweden about Islamic banking through learned scholars, so there will be no misconception.